



# Unleashing the Potential of US Foundation Endowments:

Using Responsible Investment to Strengthen  
Endowment Oversight and Enhance Impact





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## Foreword

A small but growing number of US foundations are investigating or pursuing sustainable and responsible investing approaches—often employing such terms as mission-related investing or impact investing. They are embracing the notion that in addition to making grants, they can employ investment and shareowner strategies across their assets to help achieve positive societal outcomes and targeted financial returns. This report is designed for foundation staff and trustees who are interested in encouraging their institutions to align a broader portion of their assets under management with their programmatic goals or to factor environmental, social and corporate governance (ESG) issues into their investment decisions to help fulfill fiduciary duties. Practitioners in the sustainable and responsible investment industry who serve foundations, including consultants, research providers, financial advisors, and investment managers, can also benefit from the information and resources in this paper.

Using extensive data from primary and secondary resources, this paper presents the current range and state of involvement by foundations in sustainable and responsible investing (SRI) and profiles a number of foundations whose approaches to SRI have resulted in meaningful environmental, social or corporate governance outcomes. It demonstrates that it is feasible for foundations to invest their endowments in alignment with their mission and ESG issues of concern, while at the same time achieving their overall financial goals. This report also details a range of resources, including many that have emerged just in the past few years, available to foundations in their efforts to explore SRI. Last, the report offers recommendations and ideas for foundation officers and trustees to enable them to guide their institutions into this space.

Ultimately, we hope this report will mobilize foundations to leverage the untapped investment resources at their disposal for positive societal impact.

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US SIF is the US membership association for professionals, firms, institutions and organizations engaged in sustainable and responsible investing. US SIF and its members advance investment practices that consider environmental, social and corporate governance criteria to generate long-term competitive financial returns and positive societal impact. US SIF's members include investment management and advisory firms, mutual fund companies, research firms, financial planners and advisors, broker-dealers, banks, credit unions, community development organizations, non-profit associations, and pension funds, foundations and other asset owners.

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## Introduction

More than 100 US foundations today pursue some form of sustainable and responsible investing, an investment discipline that considers environmental, social and corporate governance criteria to generate long-term competitive financial returns and positive societal impact. The US SIF Foundation, in its 2012 survey of US institutional asset owners and asset managers, identified 95 foundations that applied one or more ESG criteria in selecting investments for their portfolios, up from 58 in 2010, and the assets to which these ESG criteria were applied amounted to \$60.3 billion,<sup>1</sup> or about 9 percent of the estimated \$646 billion in total foundation assets that year.<sup>2</sup> In addition, at least a dozen foundations filed shareholder resolutions seeking to improve their portfolio companies' ESG practices.<sup>3</sup> The foundations identified in the 2012 survey as engaging in SRI, though, account for fewer than 1 percent of all foundations in the United States.

**Growing foundation interest:** However, foundation association executives interviewed by the US SIF Foundation suggest that the number of foundations engaged in or actively exploring sustainable and responsible investment strategies is larger, perhaps by a factor of two or three. Laura Tomasko, a Network Developer at the Council on Foundations, believes that there could be as many as 300 foundations that practice sustainable and responsible investing. Noticing the increased interest of foundations in this field, the Council on Foundations in 2012 started to build its network of impact investing field leaders and to work with others to create opportunities for foundations to participate in the conversation. Confluence Philanthropy and Mission Investors Exchange, two membership-based associations that promote mission-aligned investing, each now have more than 200 members.

The Center for Effective Philanthropy (CEP) also sees signs of growing foundation interest in SRI. In its survey of 211 foundations with \$5 million-plus in grants, over 70 reported they have made impact investments, while almost 50 said they were considering it.<sup>4</sup> Although the CEP did not define what constitutes “impact investing” for this survey, CEP President Phil Buchanan believes that the survey results indicate “something is happening—meaning there is much more still to understand.”<sup>5</sup> The organization is planning a new study to capture more granular data.

Furthermore, the Association of Small Foundations (ASF) reports in its 2013 *Foundation Operations and Management Report* that 11 percent of the 595 survey respondents, which represent typical small-staff foundations, engage in impact investing. ASF has been including impact investing within its curriculum for several years, but organized its first daylong seminar focused exclusively on impact investing in 2013.

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1. US SIF Foundation, *2012 Report on Sustainable and Responsible Investing Trends in the United States*, page 54.

2. Steven Lawrence, *Foundations, Growth and Giving Estimates*, Foundation Center, June 2012. Available at <http://foundationcenter.org/gainknowledge/research/pdf/fgge12.pdf>.

3. US SIF Foundation, *2012 Report on Sustainable and Responsible Investing Trends in the United States*, pages 109-110.

4. Nicole Wallace, “A Foundation Risks All of Its Endowment on Creating Jobs,” *Chronicle of Philanthropy*, Volume XXV, No. 13, page 21.

5. Phil Buchanan, *Foundations and Impact Investing: What Is Really Going On?* The Center for Effective Philanthropy, April 2, 2013. Available at <http://www.effectivephilanthropy.org/blog/2013/04/foundations-and-impact-investing-what-is-really-going-on/>.

**Reasons to practice sustainable and responsible investing:** Like other institutional investors, such as pension funds, university endowments, family offices, and faith-based institutions, foundations tend to be invested for the long term. Foundations are distinguished from many other institutional investors, however, by their explicit philanthropic missions. Since their emergence in the 19th century, foundations have dedicated their resources to some of the most difficult social and environmental problems in communities throughout the United States and around the world. However, while foundations make grants to address societal issues, they can inadvertently make concurrent investments from the remainder of their assets that are in direct conflict with their overall mission and grantmaking goals. A foundation that holds shares in tobacco companies, for example, could be undermining the goals represented by its grants to support anti-smoking campaigns for teenagers and other health-related programs. Such conflicts between investment policy and grant priorities can pose reputational risks for foundations.

In 2007, the Bill & Melinda Gates Foundation came under fire in a *Los Angeles Times* exposé on the foundation's \$423 million worth of investments in oil companies. The article described how the daily gas flaring of Italian petroleum company Eni, one of the Gates Foundation's investments, spewed soot and fumes into the village of Ebocha in Nigeria, bringing environmental and social destabilization to the local population.<sup>6</sup> According to the newspaper's findings, "41 percent of [the foundation's] assets, not including US and foreign government securities, have been in companies that countered the foundation's charitable goals or socially concerned philosophy."<sup>7</sup>

A more fundamental reason for foundations to adopt SRI strategies is to have additional tools to generate positive impact. Foundations and other investors that adopt SRI strategies have provided start-up capital to businesses with social missions and invested in vehicles supporting community development. They have used shareholder advocacy and other communication methods to help persuade the management of publicly traded companies to improve their labor, environmental and corporate governance policies.<sup>8</sup>

Moreover, analyzing portfolio companies on ESG performance and policies can enable investors and analysts to identify investment risks and opportunities. How companies disclose their social and environmental impacts, risk and performance and whether they adhere to codes of conduct in areas such as board oversight, climate risk, executive pay, human rights, supply chain management and use of toxic chemicals are questions that sustainable investment analysts now routinely ask to assess the long-term investment potential of portfolio companies.

**Focus on private foundations:** This report focuses primarily on private endowed foundations. The Forum for Regional Associations of Grantmakers defines foundations broadly as non-profit organizations that support charitable activities for the public good.<sup>9</sup> A private foundation is distinguished from a public charity in that it is funded by a single source—such as one individual, family or corporation—rather than multiple sources. Therefore, private foundations do not depend on public charity and do not actively fundraise or apply for grants. According to Foundation Source, there are approximately 80,000 private foundations in the United States.<sup>10</sup> The most common type of private foundations—private endowed foundations—

6. Robyn Dixon, Charles Piller and Edmund Sanders, "Dark Cloud Over Good Works of Gates Foundation," *Los Angeles Times*, January 7, 2007. Available at [http://www.latimes.com/news/la-na-gatesx07jan07\\_0,2533850.story?page=1](http://www.latimes.com/news/la-na-gatesx07jan07_0,2533850.story?page=1).

7. Ibid.

8. See US SIF Foundation, *The Impact of Sustainable and Responsible Investment*, 2013, for a fuller examination. Available at [http://www.ussif.org/files/Publications/USSIF\\_ImpactofSRI\\_916F.pdf](http://www.ussif.org/files/Publications/USSIF_ImpactofSRI_916F.pdf).

9. Forum of Regional Associations of Grantmakers, Grantmaking FAQs. Available at [http://www.givingforum.org/s\\_forum/doc.asp?CID=25&DID=6158](http://www.givingforum.org/s_forum/doc.asp?CID=25&DID=6158) (accessed October 2013).

have created endowments that are invested to generate returns and sustain the foundations' long-term financial viability.

## 10 Largest Private Foundations in the United States by Asset Size

FOUNDATION	TOTAL ESTIMATED ASSETS (BILLIONS \$)	AS OF FISCAL YEAR-END DATE
Bill & Melinda Gates Foundation	\$34.64	12/31/2011
Ford Foundation	\$10.98	9/30/2012
Robert Wood Johnson Foundation	\$8.97	12/31/2011
William and Flora Hewlett Foundation	\$7.74	12/13/2012
Lilly Endowment	\$7.28	12/31/2012
W.K. Kellogg Foundation	\$7.26	8/31/2012
David and Lucile Packard Foundation	\$5.80	12/31/2011
John D. and Catherine T. MacArthur Foundation	\$5.70	12/31/2011
Gordon and Betty Moore Foundation	\$5.37	12/31/2011
Andrew W. Mellon Foundation	\$5.26	12/31/2011

Source: <http://foundationcenter.org/findfunders/topfunders/top100assets.html> (accessed October 2013).

Under the Tax Reform Act of 1969, private foundations are mandated by the US Internal Revenue Service to make an annual 5 percent “qualifying distribution” from their assets, which is “intended to assure that they serve the public good.”<sup>11</sup> Foundations commonly meet this requirement through the distribution of grants, but the IRS also allows them to make program-related investments (PRIs), which it defines as investments that provide capital to non-profit and for-profit enterprises primarily to advance the mission of the giving foundation. Income generation must not be a “significant purpose” of the investment.<sup>12</sup> While PRIs must be repaid by the receiving entity, they can be repaid at below-market rates. The re-

turned money is then available for future investments or other purposes. According to Grant Space, a service of the Foundation Center: “PRIs include financing methods commonly associated with banks or other private investors, such as loans, loan guarantees, linked deposits, and even equity investments in charitable organizations or in commercial ventures for charitable purposes.”<sup>13</sup>

**Looking beyond 5 percent for impact:** The IRS 5-percent rule may have had the side effect of gearing foundations towards meeting only a 5-percent target for social good. This report—and many foundations—advocate that foundations consider ESG issues in their investment selection and ownership decisions across their assets more broadly, not only to advance their missions but to fulfill fiduciary duty.

Foundations that look beyond the 5-percent target often use the term “mission-related investing” (MRI) to describe investment policies that seek to advance positive ESG outcomes but at market-rate financial returns. MRIs can be deployed across asset classes. Unlike program-related investments, they do not contribute towards the 5 percent distribution requirement of private foundations. In 2011, when the Foundation Center

10. Foundation Source, *First Annual Report on Private Foundations*, 2012, page 2. Available at [http://www.foundationsource.com/resources/FS\\_2012\\_Annual\\_Report.pdf](http://www.foundationsource.com/resources/FS_2012_Annual_Report.pdf).

11. Foundation Center, <http://foundationcenter.org/getstarted/onlinebooks/ff/text.html> (accessed October 2013).

12. Mission Investors Exchange, Program-related Investments (PRIs). Available at <https://www.missioninvestors.org/mission-investing/program-related-investments-pris> (accessed October 2013).

13. Grant Space, What is a program-related investment? Available at <http://grantspace.org/Tools/Knowledge-Base/Grantmakers/PRIs> (accessed October 2013).



tracked data on mission-related investments for the first time, it identified at least 82 foundations that made MRIs.<sup>14</sup> However, as Stephanie Gripne of the Impact Finance Center points out, there is no legal definition for mission-related investments as there is for PRIs, and no current way to easily identify foundations that use this strategy short of asking them. Some foundations voluntarily report their MRI activities, but the current total number of foundations engaged in mission-related investing is unknown. The Impact Finance Center, a joint partnership between the University of Denver Daniels College of Business and Rockefeller Philanthropy Advisors—Sustainable Endowments Institute, is undertaking a major research project on MRIs and PRIs. The team intends to interview hundreds of foundations and collect data during 2014–15 to estimate the potential supply of PRI and MRI capital.

Foundations use a number of terms to describe their approaches to apply mission-related or other ESG criteria to their endowments. The Mission Investors Exchange, an organization that assists foundations interested in mission-related or program-related investing, uses “mission investing” to cover both MRIs and PRIs. Foundations also often use “impact investing” to encompass both mission-related and program-related investing. Impact investing has typically referred to private equity and venture capital funds and loan funds rather than investments in public securities. However, foundations need not confine their efforts to these asset classes to make an impact: several foundations see positive impact from their engagement with publicly traded companies. Some foundations

## Common Responsible Investment Terms

### PROGRAM-RELATED INVESTMENT (PRI)

PRIs are defined by the IRS tax code. They constitute investments for which the primary purpose is to accomplish one or more of the foundation’s exempt purposes, and for which production of income or appreciation of property is not a significant purpose. A PRI may produce at market, above market, or below market returns. A PRI is eligible to count against the 5 percent payout that foundations are required to make each year to retain their tax-exempt status. (Adapted from the Internal Revenue Service)

### MISSION-RELATED INVESTMENT (MRI)

MRIs are market-rate investments that support the mission of the foundation by generating a positive social or environmental impact. These investments are made from the foundation’s endowment corpus. MRI opportunities exist across asset classes in cash, fixed income, public equity, private equity and venture capital, and real estate. (Adapted from Mission Investors Exchange)

### MISSION INVESTMENTS

This term comprises both MRIs and PRIs. (Mission Investors Exchange)

### IMPACT INVESTING

Impact investments are investments made into companies, organizations, and funds with the intention to generate measurable social and environmental impact alongside a financial return. (Global Impact Investing Network—GIIN)

### SUSTAINABLE AND RESPONSIBLE INVESTMENT (SRI)

SRI is an investment discipline that considers environmental, social, and corporate governance (ESG) criteria to generate long-term competitive financial returns and positive societal impact. SRI strategies include both ESG incorporation in investment decision-making as well as shareholder engagement. Most SRI investors seek market-rate returns, but some accept below-market returns to achieve outsized environmental or social impact. SRI can be practiced across all asset classes. (US SIF Foundation)

14. Ibid.

prefer to describe their activities as “socially responsible investing.” These terms can be understood as subsets of, and in some cases synonyms for, “sustainable and responsible investment,” as shown in the chart on the previous page.

***“Investing can mean many different things, entrepreneurialism can mean many different things, philanthropy can mean different things. Never settle for one simple definition of a word or an approach, because trying different things means we can find more bottom lines, not just one... and in this way we can change the world.”***

—STERLING SPEIRN, FORMER PRESIDENT AND CEO OF THE W.K. KELLOGG FOUNDATION<sup>15</sup>

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15. W.K. Kellogg Foundation President and CEO Sterling Speirn at TEDxUofM talk. Available at <http://www2.wkkf.org/impactinvesting> (accessed October 2013).

# 1. A Guide to Sustainable and Responsible Investing

## SRI Strategies

Foundations can employ various responsible investment strategies to serve their values and missions and to obtain targeted financial returns. While generally the financial objective will be to achieve market-rate returns, or to match or beat a benchmark, some investors with philanthropic motives may also select investment vehicles that will deliver below-market returns but outsized social impact.

Two broad SRI approaches are **ESG Incorporation** and **Shareholder Engagement**.

ESG incorporation is the practice of evaluating investments using environmental, community, other societal, and/or corporate governance criteria in addition to traditional financial analysis. Avoiding stocks in tobacco and other products or industries of concern is one common practice among ESG screened mutual funds and separate account strategies. However, SRI strategies today go beyond avoidance to more innovative assessments of the environmental, social and corporate governance performance of investments in order to manage risk and identify companies with competitive advantages over their peers.

ESG incorporation can be accomplished in numerous ways:

- **Positive screening:** proactively investing in companies with good ESG practices
- **Exclusionary screening:** avoiding or divesting from companies with poor ESG practices
- **Full ESG integration:** explicitly including an assessment of ESG risks and opportunities into all processes of investment analysis and management
- **Thematic investing:** targeting specific themes such as climate change, water or human rights

Institutional asset owners across the United States considered ESG criteria in investment analysis and portfolio selection for aggregate assets of \$2.48 trillion as of year-end 2011, a 23 percent increase since the start of 2010.<sup>16</sup>

Mission-related investing is compatible with the ESG incorporation framework. ESG incorporation can be applied across all asset classes, including alternative investment vehicles such as private equity and venture capital, hedge funds, and property and real estate funds. Alternative investment funds that consider ESG criteria or themes in fact have been one of the fastest growing segments in the broader SRI industry.

Community investing—investments that direct capital and financial services to underserved communities—also falls under the rubric of ESG incorporation. Community investing puts money at risk or on deposit, with the expectation of repayment with a financial return. Both return of capital and return on capital are expected, although some investments have concessionary rates of return that may make them suitable as program-related investments. Community investing is historically known to investors through community development banks, credit unions, and loan and venture capital funds, often registered with the US Treasury as community development finance institutions (CDFIs). In recent years, interest has expanded across a

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16. US SIF Foundation, *2012 Report on Sustainable and Responsible Investing Trends in the United States*, page 46.

wider range of asset classes, such as real estate funds and international microfinance, and into new sectors, driven by new ideas about how to serve, and measure benefits for, marginalized communities.

Shareholder engagement is the other principal approach to SRI. It involves the actions sustainable investors take as asset owners to communicate to the managements of portfolio companies their concerns about the companies' ESG policies and to ask management to study these issues and make improvements. Investors can communicate directly with corporate management or through investor networks. For owners of shares in publicly traded companies, shareholder engagement can take the form of filing or co-filing shareholder resolutions on ESG issues and conscientiously voting their shares on ESG issues that are raised at the companies' annual meetings.

Investors today commonly use shareholder engagement to complement and reinforce their ESG incorporation strategies. Shareholder resolutions on ESG issues have gained traction in recent years. Governance proposals, particularly on ways to hold corporate boards and top executives more accountable, frequently receive majority support. It is no longer uncommon for shareholder proposals that address climate change and other environmental risks, request reporting on sustainability, call for disclosure and governance of political spending and urge fair employment practices to get the support of more than 30 percent of the shares voted. Shareholder proposals often help to persuade corporate managements to improve their disclosure and policies.<sup>17</sup> Between 2010 and 2012, at least 176 institutional investors with \$1.28 trillion in assets had filed or co-filed shareholder resolutions on ESG concerns.<sup>18</sup>

## SRI Today

The growth in support for the Principles for Responsible Investment, launched by the United Nations in 2006, is indicative of the growing interest of investors worldwide in SRI. The number of signatories jumped from 100 in April 2006 to over 1,200 as of November 2013. Assets under management represented by the signatories increased from \$6.5 trillion in 2006 to \$34 trillion in 2013. Signatories commit to the following six principles:

### Principles for Responsible Investment

**Principle 1:** We will incorporate ESG issues into investment analysis and decision-making processes.

**Principle 2:** We will be active owners and incorporate ESG issues into our ownership policies and practices.

**Principle 3:** We will seek appropriate disclosure on ESG issues by the entities in which we invest.

**Principle 4:** We will promote acceptance and implementation of the Principles within the investment industry.

**Principle 5:** We will work together to enhance our effectiveness in implementing the Principles.

**Principle 6:** We will each report on our activities and progress towards implementing the Principles.

17. Ibid, page 69.

18. Ibid, page 68.

The millennial generation, encompassing individuals born between 1980 and around 2000, and which has been encumbered by the 2008 financial crisis, half a decade of high unemployment and climate change, is adding to the demand for investments that consider environmental and societal impacts and corporate governance issues. According to a survey by Merrill Lynch Private Bank and Investment Group, 30 percent of millennial investor respondents said that “values-based investing” options were important in selecting a wealth management firm.<sup>20</sup> Chris Wolfe, the chief investment officer of the group, explained that “[e]nvironmental concerns were often the top priority.”<sup>21</sup> Anecdotal evidence from investment managers also demonstrates increased millennial interest in SRI. Martin Whittaker, a managing director at Sonen Capital in San Francisco, has said: “Our experience has been that typical family offices are now getting very interested in impact investing and that interest has been driven by the younger generation....”<sup>22</sup>

John Powers, a member of the board of the Educational Foundation of America, agrees that millennials are driving change, telling the US SIF Foundation: “Forty-nine percent of millennials worth over \$1 million in investable assets are already using ESG criteria in their investments. Every firm on Wall Street is starting to put out white papers on the subject and is developing products and ideas for their clients. Within the next decade, utilizing ESG factors will be the norm for investing and identifying best business practices.”

Another driver of SRI is concern about climate change. In order to limit planetary warming to no more than 2°C (3.6°F) above the average global temperature before the Industrial Revolution, only 20 percent of the earth’s remaining carbon reserves can be burned.<sup>23</sup> Policy efforts at the global and national level to address climate change are a work in progress. A 2011 study by global consulting company Mercer argues that “[u]ncertainty around climate policy is a significant source of portfolio risk for institutional investors to manage over the next 20 years,” and its findings suggest that “climate policy could contribute as much as 10 percent to overall portfolio risk....”<sup>24</sup> Furthermore, [350.org](http://350.org) and other environmental groups have mobilized students across the country in a movement to push university endowments and other investors to divest from fossil fuel investments. As of November 2013, according to a list maintained by these groups, 21 cities, 18 religious institutions, seven colleges and universities, three foundations (two private endowed and one public charity), and two counties had committed to explore fossil fuel divestment.<sup>25</sup> More broadly, a number of investors concerned about climate risk are seeking to reduce carbon-intensive investments from their portfolios and to expand renewable energy and energy efficiency investment options.<sup>26</sup>

## Fiduciary Duty

Integrating ESG criteria into investment analysis can lead investment managers to identify risks and opportunities that might be overlooked in traditional investment analysis. Therefore, considering environmental, social or corporate governance performance in the investment decision-making process can help serve the foundation’s fiduciary duty. Global law firm Freshfields Bruckhaus Deringer concluded in a 2005 study that “the links between ESG factors and financial performance are increasingly being

19. Principles for Responsible Investment, <http://www.unpri.org/about-pri/about-pri/> (accessed October 2013).

20. Mason Braswell, “BoFA Campaign Emphasizes Socially Responsible Investing,” *On Wall Street*, August 19, 2013. Available at <http://www.onwallstreet.com/news/bofa-campaign-emphasizes-socially-responsible-investing-2686240-1.html>.

21. Ibid.

22. Katie Gilbert, *Millennials Keen on Impact Investing*, Sonen Capital, September 13, 2013. Available at <http://sonencapital.com/news-2012-09-13-millennials-keen.php>.

23. Carbon Tracker Initiative, *Unburnable Carbon – Are the world’s financial markets carrying a carbon bubble?* <http://www.carbontracker.org/carbonbubble> (accessed October 2013).

24. Mercer, *Climate Change Scenarios—Implications for Strategic Asset Allocation*, February 2011. Available at <http://www.mercer.com/articles/1406410>.

25. Fossil Free, <http://gofossilfree.org/commitments/> (accessed October 2013).

26. For more information, see US SIF Foundation, *Investing to Curb Climate Change*, 2013. Available at [http://www.ussif.org/files/Publications/Institutional\\_Climate.pdf](http://www.ussif.org/files/Publications/Institutional_Climate.pdf)



recognized. On that basis, integrating ESG considerations into an investment analysis so as to more reliably predict financial performance is clearly permissible and is arguably required in all jurisdictions.”<sup>27</sup>

A 2009 update to the 2005 Freshfields report focusing primarily on institutional investors and consultants directs that, “Responsible investment, active ownership and the promotion of sustainable business practices should be a routine part of all investment arrangements, rather than the optional add-on which many consultants appear to treat it as.”<sup>28</sup>

Similarly, a 2008 report by FSG Social Impact Advisors, *A Brief Guide to the Law of Mission Investing for US Foundations*, argued that “there is considerable and growing evidence that taking social and environmental considerations into account may actually increase investment returns for the long-term investor. If so, then considering such factors would not conflict with profit maximization.”<sup>29</sup>

The primary US-based global training organization for fiduciaries and fiduciary analysts, fi360, specifies in its definitive work *Prudent Practices for Investment Stewards*, that fiduciaries that fail to consider an SRI strategy for foundations could be in breach of state trust law if the trust documents establishing the foundation permit the use of SRI or if a “reasonable person would deduce from the foundation’s/endowment’s mission that SRI would be adopted.”<sup>30</sup>

**“We take fiduciary responsibility seriously and recognize that this responsibility does not end with maximizing return and minimizing risk. We recognize that economic growth can come at considerable cost to communities and the environment and we believe that fiduciary responsibility demands that we combine prudent financial management practices with social, environmental and economic practices consistent with our mission.”**

—EXCERPTED FROM THE NEEDMOR FUND INVESTMENT POLICY<sup>31</sup>

## Financial Performance

Several research studies have demonstrated that companies with strong corporate social responsibility policies and practices tend to be sound investments. After a meta-analysis of more than 100 academic studies in 2012, Deutsche Bank Group Climate Change Advisors found that incorporating ESG data in investment analysis is “correlated with superior risk-adjusted returns at a securities level.”<sup>32</sup> A joint report by the United Nations Environment Program Finance Initiative (UNEP-FI) and Mercer examined 36 representative academic studies and 10 related industry research reports about SRI performance and found that “the evidence suggests that there does not appear to be a performance penalty from taking ESG factors into

27. Freshfields Bruckhaus Deringer, *A Legal Framework for the Integration of Environmental, Social, and Governance Issues into Institutional Investment*, UNEP Finance Initiative, October 2005. Available at [http://www.unepfi.org/fileadmin/documents/freshfields\\_legal\\_resp\\_20051123.pdf](http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf).

28. UNEP Finance Initiative 2009, *Fiduciary responsibility: Legal and practical aspects of integrating environmental, social and governance issues into institutional investment*, 2009.

29. FSG Social Impact Advisors also notes that “It is commonly assumed that fiduciary responsibility under federal and state law requires a foundation’s board to maximize the investment return on the foundation’s assets.” However, donor intent, federal tax law and fiduciary duty as stipulated in state laws together determine a foundation’s obligation to maximize financial returns. For more, see [http://www.fsg.org/Portals/0/Uploads/Documents/PDF/The\\_Law\\_and\\_Mission\\_Investing\\_Brief.pdf](http://www.fsg.org/Portals/0/Uploads/Documents/PDF/The_Law_and_Mission_Investing_Brief.pdf).

30. Fi360, *Prudent Practices for Investment Stewards*, 2013. Available at [http://www.fi360.com/main/pdf/handbook\\_steward.pdf](http://www.fi360.com/main/pdf/handbook_steward.pdf) (accessed December 2013).

31. Needmor Fund Investment Policy, <http://www.needmorfund.org/investments.htm> (accessed October 2013).

32. DB Climate Change Advisors, *Sustainable Investing: Establishing Long-Term Value and Performance*, June 2012. Available at [https://www.dbadvisors.com/content/media/Sustainable\\_Investing\\_2012.pdf](https://www.dbadvisors.com/content/media/Sustainable_Investing_2012.pdf).

account in the portfolio management process.”<sup>33</sup> Additionally, a 2011 study by GMI Ratings found that “on average and in aggregate, [responsible investment] portfolios perform comparably to conventional ones.”<sup>34</sup>

Foundations and other investors have a number of equity ESG indexes whose performance they can compare against widely used indexes such as the S&P 500 Index and MSCI USA Index. ESG indexes are found in the MSCI ESG Index Series, DJSI Series, Calvert Social Index, FTSE4Good Index Series, S&P ESG Index Series and STOXX Sustainability Index Series. ESG equities generate returns comparable to traditional equities, but performance varies by ESG index and the specific time frame under consideration.

For example, the S&P U.S. Carbon Efficient Index, comprised of a subset of S&P 500 companies with a “relatively low Carbon Footprint” as calculated by Trucost Plc, outperformed the S&P 500 Index in the 5-, 3- and 1-year annual returns to September 30, 2013,<sup>35</sup> as shown in the table on this page. The MSCI KLD 400 Social Index outperformed the MSCI USA Index in the 5- and 1-year annualized gross returns through September 30, 2013, but did slightly less well than the non-SRI benchmark in the 3-year period. The key takeaway is that ESG-screened equities can offer returns higher than or close to conventional equities.

Fixed income ESG indexes are now available as well. MSCI and Barclays jointly launched the first set of fixed income ESG indexes in June 2013, enabling investors to compare the financial performance of funds of bonds selected with ESG criteria to traditional bond funds.

ESG indexes facilitate benchmarking and can enable institutional investors to invest in index-based exchange traded funds, separately managed accounts and other investment products that incorporate ESG factors.<sup>36</sup>

Like conventional investments, responsible investing opportunities range widely across asset classes and investment styles, so investors must exercise due diligence in determining what kinds of investments are appropriate to their missions and values, asset allocation requirements and appetites for risk and return. What sets SRI vehicles apart from the conventional investment universe is the wide spectrum of opportunities that they can offer for both financial returns and positive social and environmental impact.

### Comparison of Annualized Gross Returns of Selected SRI to non-SRI Benchmarks

INDEX	1 YEAR ENDING 9/30/2013	3 YEARS ENDING 9/30/2013	5 YEARS ENDING 9/30/2013
S&P US Carbon Efficient Index	20.47%	17.24%	9.38%
S&P 500	19.52%	16.48%	9.29%
MSCI KLD 400	23.62%	16.07%	10.49%
MSCI USA	19.95%	16.49%	10.21%
Sources: S&P Dow Jones Indices, S&P Carbon Efficient Index, <a href="https://us.spindices.com/indices/equity/sp-us-carbon-efficient-index">https://us.spindices.com/indices/equity/sp-us-carbon-efficient-index</a> (accessed September 30, 2013); MSCI Indices, MSCI KLD 400 Social Index performance as of September 30, 2013, <a href="http://www.msci.com/resources/factsheets/index_fact_sheet/msci-kld-400-social-index.pdf">http://www.msci.com/resources/factsheets/index_fact_sheet/msci-kld-400-social-index.pdf</a> (accessed October 2013).			

33. UNEP Finance Initiative and Mercer, *Demystifying Responsible Investment Performance: A Review of Key Academic and Broker Research on ESG Factors*, 2007. Available at [http://www.unepfi.org/fileadmin/documents/Demystifying\\_Responsible\\_Investment\\_Performance\\_01.pdf](http://www.unepfi.org/fileadmin/documents/Demystifying_Responsible_Investment_Performance_01.pdf).

34. Kimberly Gladman, *Ten Things to Know about Responsible Investing and Performance*, Governance Metrics International, GMI Ratings, 2011. Available at [http://www3.gmiratings.com/wp-content/uploads/2012/10/GMIRatings\\_10Things\\_102012.pdf](http://www3.gmiratings.com/wp-content/uploads/2012/10/GMIRatings_10Things_102012.pdf).

35. S&P Dow Jones Indices, S&P U.S. Carbon Efficient Index Equity Indices Factsheet, downloaded October 2013 from <https://us.spindices.com/indices/equity/sp-us-carbon-efficient-index>.

36. Avery Fellow, Barclays, *MSCI Issue Fixed-Income Sustainability Indices*, Bloomberg, June 12, 2013. Available at <http://www.bloomberg.com/news/2013-06-12/barclays-msci-issue-fixed-income-sustainability-indices.html>.

## Resources and Services

An increasing number of services and resources are available that minimize the time and expenses for foundations to conduct ESG analysis in their portfolio construction and management, invest in communities and ESG alternative investment vehicles, and engage in shareowner advocacy.

Numerous financial advisors, investment consultants and investment managers offer services for foundations that would otherwise lack the internal capacity to construct and monitor their SRI portfolios. Many of these specialists can be found in the online [US SIF Financial Services Directory](#). In addition, US SIF lists members' SRI mutual funds in its [Sustainable and Responsible Mutual Fund Chart](#) and provides a list of member [separate account managers with SRI strategies](#).

A number of market-rate and below-market instruments in community investing can be integrated into institutional fixed income, cash and equity portfolios. Many community development banks and credit unions offer market-rate deposits. Other community investing institutions and community development bond funds and intermediaries provide competitive risk-adjusted returns with costs similar to conventional cash or fixed income investments. Foundations can find banks, credit unions and loan funds that specialize in community development from such networks as the Coalition of Community Development Financial Institutions (CDFI Coalition), Community Development Bankers Association, National Community Investment Fund, National Federation of Community Development Credit Unions, and the Opportunity Finance Network.

Foundations can use ratings services to facilitate identification of community investment opportunities that are appropriate for their social mission and investment goals. CARS™, an independent rating service, assesses the impact and financial performance of loan funds designated as CDFIs by the US Treasury's CDFI Fund.<sup>37</sup> In 2007 the National Community Investment Fund (NCIF), a non-profit private equity trust that invests in community development banking institutions, created metrics to rate banks (including CDFIs and other banks) on their level of engagement with low and moderate income communities. In October 2013, NCIF launched BankImpact, an online resource offering financial information and proprietary Social Performance Metrics on all banks in the United States.<sup>38</sup>

For those foundations seeking to incorporate ESG issues into private equity, venture capital and other alternative investments, the Global Impact Investment Network (GIIN) provides numerous resources. GIIN, a non-profit organization sponsored by Rockefeller Philanthropy Advisors, created and manages ImpactBase, a global online directory of impact investment vehicles where foundations and other accredited investors, as well as financial advisors, can subscribe to view fund managers and financial intermediaries active in impact investing. ImpactBase tracked over 270 fund and product profiles as of November 2013.<sup>39</sup> GIIN also provides research on impact investing, as well as networking and collaboration opportunities for members and industry stakeholders. In addition, ImpactAssets, a non-profit financial services company seeking to catalyze impact investing, has launched ImpactAssets 50, a database of 50 fund managers specializing in private debt and equity impact investing. The list features experienced fund managers representing a wide range of asset classes, sectors and geographies. Updated annually, this resource is publicly available.

The Global Impact Investment Rating System (GIIRS), a project of non-profit B Lab, is a ratings agency that assesses the social and environmental impact of both funds and companies. According to GIIRS, the ratings product can be used by foundations and other investors “to evaluate, screen, manage, and

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37. CARS™ Rating System, <http://carsratingsystem.net/ratings/> (accessed October 2013).

38. National Community Investment Fund, BankImpact <http://www.bankimpact.org/> (accessed October 2013).

39. Global Impact Investing Network, ImpactBase <http://www.thegiin.org/cgi-bin/iowa/impactbase/index.html> (accessed October 2013).

## Potential Responsible Investing Strategies for Foundations by Mission Area

FOUNDATION MISSION AREA	POTENTIAL INVESTOR AND SHAREOWNER ACTIONS FOR GREATER IMPACT
HEALTH	Avoid investing in companies that profit from unhealthy products such as tobacco.
	Ask companies you own to provide their employees with high-quality, affordable healthcare benefit plans—instead of externalizing those costs onto society and public health systems.
	Vote your shares to support resolutions that call for corporations to improve access to health care or to improve the health and safety of their products.
	Make community investments to support affordable, community-based health care, fresh and healthy food options in low-income neighborhoods and equitable transit-oriented development.
ENVIRONMENT	Avoid investing in companies that are carbon-intensive or have poor environmental performance.
	Use investment managers that assess companies on environmental performance and risk.
	Invest in private equity and venture capital funds that finance companies providing clean technology and environmental services.
	Join investor coalitions calling for companies to mitigate the risks of global climate change and toxics.
	Support shareowner resolutions brought by environmentally concerned investors.
	Invest in community investing institutions that finance environmental projects.
HUMAN RIGHTS	Use investment managers that assess companies on human rights policies and risk.
	Support shareowner initiatives to ensure that multinational companies take steps against human rights abuses—including forced labor and human trafficking—in their operations and supply chains and adequately address harm from their operations on local communities around the world.
COMMUNITY DEVELOPMENT	Commit a portion of your portfolio to community investing institutions, either directly or through a community investing intermediary.
	Invest in companies with strong community relations programs.

communicate the social impact of their sustainable private equity and debt investments, as well as other financial instruments.”<sup>40</sup> As of 2013, GIIRS had rated 63 funds and 409 companies.<sup>41</sup> Rated funds with detailed descriptions are publicly featured on the GIIRS website.<sup>42</sup>

40. Global Impact Investing Ratings System brochure. Available at <http://www.rockefellerfoundation.org/uploads/files/ad22d5f4-305d-4a8b-92c6-6ddd074d0567.pdf>.

41. Global Impact Investing Ratings System, Powered by B Lab <http://giirs.org/powered-by-b-lab> (accessed October 2013).

42. Global Impact Investing Ratings System, Fund Directory <http://giirs.org/for-investors/fund-directory> (accessed October 2013).

## Potential Responsible Investing Strategies for Foundations by Mission Area

FOUNDATION MISSION AREA	POTENTIAL INVESTOR AND SHAREOWNER ACTIONS FOR GREATER IMPACT
<b>SOLUTIONS TO SOCIAL PROBLEMS AND POVERTY</b>	<p>Hold the companies you own accountable for their social impact—ask about executive compensation levels and work conditions. Ask financial services institutions about their lending and banking policies.</p> <p>Invest in community investing institutions, including microfinance, in the United States and around the world, to create opportunities in underserved communities and markets.</p>
<b>TRANSPARENCY AND CIVIC PARTICIPATION</b>	<p>Join investor networks supporting greater corporate transparency and accountability.</p> <p>Join other investors in filing or supporting resolutions that ask companies to separate the positions of CEO and chair, increase board diversity, and ensure that executive pay is properly aligned with measures of corporate responsibility and the goal of long-term growth.</p> <p>Encourage portfolio companies—through shareholder resolutions, proxy voting and investor networks—to disclose their corporate political and lobbying expenditures and to have their boards assess the potential reputational risk of these activities.</p>
<b>SUSTAINABLE GLOBAL DEVELOPMENT</b>	<p>Direct a portion of your investments to international microfinance opportunities.</p> <p>Support shareowner initiatives that call for more sustainably harvested, fairly traded products.</p> <p>Support shareowner initiatives to ensure that multinational companies take steps against human rights abuses—including forced labor and human trafficking—in their operations and supply chains and adequately address harm from their operations on local communities around the world.</p>
<b>DIVERSITY AND EQUAL EMPLOYMENT OPPORTUNITY</b>	<p>Use shareowner strategies to encourage companies to diversify their boardrooms, to break glass ceilings for women and minorities throughout their organizations, and to improve their policies and practices related to non-discrimination for all classes of employees.</p>
<b>FOOD, AGRICULTURE OR RURAL DEVELOPMENT</b>	<p>Use shareowner strategies that call for more sustainably harvested, fairly traded products and encourage companies to reduce their use of water and to assess the impact of their water use on local global communities.</p> <p>Invest in community investing institutions providing financing to distressed rural areas and agricultural initiatives.</p>

To operate as an engaged shareholder for investments in publicly traded companies, foundations can work with shareholder coalitions and proxy advisory firms to develop targeted engagement strategies or join with other investors in shareholder campaigns. Some of these resources are As You Sow Foundation, the Ceres Investor Network on Climate Risk (INCR), Confluence Philanthropy through its Proxy Power Program and Proxy Stewardship Initiative, the Interfaith Center on Corporate Responsibility (ICCR), Investor Voice and US SIF. ISS, a division of MSCI, and Glass Lewis help institutional investors develop proxy voting guidelines



and also offer proxy voting services. Sustainable Investments Institute (Si2) provides research and analysis on the issues raised by shareholder resolutions ahead of the voting deadlines.

Networking and learning from other foundation members exploring or already involved in SRI can also be a helpful resource. The following chapters in this report present recent SRI trends among foundations and highlight examples of foundations that are employing various responsible investment practices. Links to select foundation SRI policies are listed in the resources section at the end of this report. The table on the preceding two pages shows how foundations can employ SRI strategies in relation to their mission areas and other organizational goals.

## 2. Putting Responsible Investing Strategies to Work: ESG Incorporation

As noted in the Introduction, at the start of 2012, the US SIF Foundation identified 95 foundations in the United States that applied some form of ESG criteria to assets collectively totaling \$60.3 billion.

The most prominent ESG incorporation strategy foundations employ, when measured by the value of assets affected, is exclusionary screening. The leading ESG criterion considered by foundations was tobacco, affecting more than \$58 billion in assets. Policies on targeted divestment from companies doing business in Sudan affect the second largest pool of foundation assets—more than \$36 billion at year-end 2011. The next three ESG issues for foundations, in asset-weighted terms, are criteria on avoiding investments related to alcohol (affecting \$14 billion in assets), military contracting and weapons production (\$10 billion) and gambling (\$5 billion).

Some foundations have comprehensive screening policies across several issue areas. For example, the Merck Family Fund excludes companies that generate over 5–10 percent of their revenues from gambling products and services, tobacco products and services, nuclear power production, uranium mining or processing, gold mining, and weaponry production or sales.<sup>43</sup>

Foundations also can employ a broad range of positive screens. Foundations often apply community development and environmental criteria through investments in alternative vehicles focused on climate, clean technology or sustainable natural resources, through deposits with community development financial institutions, and through program-related investment portfolios. Environmental and community issues were included in the management of \$2.6 and \$2.3 billion in philanthropic assets, respectively, at the start of 2012.

The table on pages 19–21 presents examples of foundations that are applying mission-related or other ESG criteria to some or all of their endowments. On pages 21–31 we profile several foundations in more detail. Most of the profiled foundations are applying ESG criteria across a substantial portion of their portfolios, many as a result of policies they adopted in the last several years, but a few have practiced SRI for a much longer period. For some foundations, consideration of ESG criteria started with or centers on program-related investing, but the process of developing PRIs also prompted interest in mission alignment over a broader range of assets. Because mission investing and SRI can be practiced across a range of asset classes, this chapter also highlights foundations that are pursuing community investing and alternative investments.

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43. Merck Family Fund, Financials, [http://merckff.org/?page\\_id=13](http://merckff.org/?page_id=13) (accessed October 2013).

## Examples of Foundations Employing ESG Incorporation

FOUNDATION	ESG INCORPORATION ACTIVITIES	TOTAL ESTIMATED ASSETS (MILLIONS \$)	AS OF YEAR-END
<b>Annie E. Casey Foundation</b>	Makes mission-related deposits to CDFIs, such as credit unions, typically structured as share certificates or certificates of deposit.	\$2,670	2011
<b>Bill &amp; Melinda Gates Foundation</b>	Screens out tobacco companies and companies doing business in Sudan. Has venture investments supporting its mission of advancing global health and development and the US education system.	\$34,640	2011
<b>Blue Moon Fund</b>	Aligns its investments in public equities, fixed income, private equity and real asset investments with mission.	\$161	2011
<b>California Endowment</b>	Screens tobacco from its investments. Program-related investments and mission-related investments comprise 2–5 percent of its endowment.	\$3,660	2012
<b>Cedar Tree Foundation</b>	Views investments as an integrated component of its mission. Since 2008, has worked with its investment consultant to apply its mission-related investment policy mandate while maintaining competitive financial returns.	\$95	2011
<b>Christopher Reynolds Foundation</b>	Describes itself as a sustainable investor that seeks investments that are future-oriented, risk-adjusted and opportunity-directed within the context of financial analysis. Invests toward the public benefit, which it considers its fiduciary duty.	\$24	2012
<b>Cordes Foundation</b>	Thirty percent of its portfolio is in impact investments that support areas including education, health care, job creation and the empowerment of women and girls.	\$11	2012
<b>Educational Foundation of America</b>	Since 1994, has worked to invest 100 percent of its assets for impact. Employs “Best of Sector” screening to align investments with foundation values. Has committed to divest from all fossil fuel assets by 2014 and to reinvest in clean technologies.	\$141	2011
<b>F.B. Heron Foundation</b>	Plans to fully invest its \$274 million endowment over the next five years to address job creation.	\$241	2011
<b>Hull Family Foundation</b>	100 percent of foundation assets are mission-aligned.	\$22	2011
<b>Jessie Smith Noyes Foundation</b>	Allocates over 80 percent of its assets to mission-related investments. Employs exclusionary and positive screens on: environmental justice, toxic emissions, extractive industries, sustainable agricultural and food systems, reproductive health and rights, and a sustainable and socially just society.	\$42	2011

## Examples of Foundations Employing ESG Incorporation

FOUNDATION	ESG INCORPORATION ACTIVITIES	TOTAL ESTIMATED ASSETS (MILLIONS \$)	AS OF YEAR-END
<b>John D. and Catherine T. MacArthur Foundation</b>	Has been making program-related investments since 1986, and is holding discussions at board level about making mission-related investments in program areas such as residential energy efficiency initiatives.	\$5,700	2011
<b>Jubitz Family Foundation</b>	Committed to divesting its endowment from fossil fuels and prohibiting any investments in carbon-intensive industries.	\$13	2012
<b>KL Felicitas Foundation</b>	Working towards investing its full endowment in mission-related investments and other types of sustainable and responsible investments by the end of 2013. As of 2012, 85 percent of the endowment was in impact investments.	\$10	2011
<b>Mary Reynolds Babcock Foundation</b>	Aims to make mission-related investments in companies that support emerging markets development, community investing and clean energy technology. Currently invests in PRIs for community development.	\$162	2012
<b>Merck Family Fund</b>	Favors companies that have codes of conduct espousing social rights, such as just wages and safe working conditions, and freedom of association. Also favors companies that protect the environment. Excludes companies that generate over 5–10 percent of their revenues from gambling products/services, tobacco products/services, nuclear power production, uranium mining or processing, gold mining and weaponry production or sales.	\$48	2011
<b>Nathan Cummings Foundation</b>	Recently began making mission-related investments for community development, including certificates of deposit in CDFIs.	\$403	2011
<b>Needmor Fund</b>	Employs positive and exclusionary screens for 90 percent of its assets, in the areas of human rights, weapons production, energy, the environment, product quality, employee relations, and community relations.	\$23	2011
<b>Park Foundation</b>	Is 100 percent invested for impact with a combination of “Best of Sector,” shareholder engagement, and mission/program related investing while operating within the organization’s risk/return parameters.	\$335	2011
<b>Robert Wood Johnson Foundation</b>	Screens out companies that primarily manufacture or sell tobacco, alcohol or firearms.	\$8,970	2011

## Examples of Foundations Employing ESG Incorporation

FOUNDATION	ESG INCORPORATION ACTIVITIES	TOTAL ESTIMATED ASSETS (MILLIONS \$)	AS OF YEAR-END
<b>Rockefeller Foundation</b>	Employs negative screening for tobacco companies. Social investing guidelines include evaluating some investments with an investment screen first and then a social screen. Makes for-profit impact investments and program-related investments.	\$3,510	2011
<b>Russell Family Foundation</b>	Practices include screened funds, certificates of deposit at local community financial institutions, and program-related investments. Is divesting from coal companies.	\$129	2011
<b>Skoll Foundation</b>	Aligns its endowment with its mission. Uses a “principled investing approach” that incorporates social, environmental and ethical factors.	\$472	2011
<b>Swift Foundation</b>	Has committed to investing an increasing portion of its assets to mission-related investments. Currently 30 percent is allocated towards MRIs in areas that include supporting the environment and the health of communities.	\$52	2012
<b>W.K. Kellogg Foundation</b>	Has allocated \$100 million of its endowment to “Mission Driven Investments,” which it defines as investing that has both a “strong mission fit and market, or near-market financial performance.”	\$7,260	2012
<b>Wallace Global Fund</b>	Has a 100 percent mission-aligned endowment that uses positive, negative, and best-in-class screens, and allocates 5 percent of its endowment for impact investments. Is currently 99 percent divested from fossil fuels and plans to be completely fossil-free by 2014.	\$148	2011

*Note: This is a sample, rather than a comprehensive list, of private foundations considering ESG criteria in investment analysis. The value of total assets under management is drawn from 990 forms and other public sources as of the years indicated.*

### Mission-Related Investment

According to data from the Foundation Center, at least 82 foundations made mission-related investments in 2011,<sup>44</sup> and the total number, as mentioned in the Introduction, may be as high as 300. A sampling of these strategies is found below.

**F.B. Heron Foundation:** The F.B. Heron Foundation, which is committed to helping economically disadvantaged families and communities to prosper, began re-evaluating its goals and strategies two years ago with the arrival of new executive director Clara Miller. The staff and board members concluded that Heron’s historic focus on housing and wealth acquisition was becoming less effective in the current

44. Steven Lawrence and Reina Mukai, *Key Facts on Mission Investing*, Foundation Center, October 2011. Available at [http://foundationcenter.org/gainknowledge/research/pdf/keyfacts\\_missioninvesting2011.pdf](http://foundationcenter.org/gainknowledge/research/pdf/keyfacts_missioninvesting2011.pdf).



economic environment, in which “[e]mployment at a living wage is neither reliable nor commonplace.”<sup>45</sup> As a result, they decided it would be more effective to focus on employment and reliable income as the primary mechanism to help disadvantaged individuals and families.

Over the next five years, the foundation plans to fully invest its \$274 million endowment in line with its mission.<sup>46</sup> To meet this challenge, Heron reorganized its staff, creating a “capital deployment team” that focuses on both grants and investments, rather than having two teams that work on each area separately.<sup>47</sup> The new joint team is making direct capital investments to both for-profit and nonprofit enterprises that have the potential to improve the employment picture as well as working through impact-related managers. Heron recently invested in Ecologic Brands, an eco-friendly packaging company that is committed to improving the skills and livelihood of its employees.<sup>48</sup> It also is invested in private equity real estate fund Northwest Louisiana Community Development Fund I LLC via a \$500,000 nine-year membership interest, approved in 2007.<sup>49</sup> The fund finances local real estate projects with the purpose of revitalizing low and moderate income communities in northwest Louisiana and creating job growth.<sup>50</sup>

**KL Felicitas:** KL Felicitas, dedicated to empowering impact investors and scaling impact enterprises, has a mission-oriented investment strategy that seeks to leverage as many aspects of its structure and activities as possible to maximize impact. Sonen Capital serves as its investment management firm and also extends expertise in environmental and social impact.

By the end of 2013, the foundation plans to have 100 percent of its assets in impact investments, which it defines as “investing with the intent to generate both financial returns and purposeful, measurable, positive social or environmental impact.”<sup>51</sup> The foundation increased its impact investments from 2 percent to 85 percent of assets between 2006 and 2012.

KL Felicitas classifies its impact investments into two categories: Return-Based, which seeks market-rate financial returns, and Impact First, where below-market financial returns are acceptable to achieve greater impact. The primary focus of the foundation is on return-based impact investments, with impact first investments considered on a case-by-case basis.

As of year-end 2012, approximately 75 percent of the foundation’s portfolio was in return-based impact investments and about 10 percent in impact first investments.<sup>52</sup> KL Felicitas has around 21 percent of its assets in “high-impact” return-based investment vehicles that support a particular impact theme, such as clean water, or foundation program. These thematic vehicles include Core Innovation Capital I, Microvest I and II, Sail Safe Water Partners, and Sonen Global Fixed Income.<sup>53</sup> Roughly 54 percent of assets are in a mix of sustainable and responsible investment strategies that integrate environmental, social and governance

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45. The F.B. Heron Foundation, <http://www.fbheron.org/> (accessed October 2013).

46. Nicole Wallace, “A Foundation Risks All of Its Endowment on Creating Jobs,” *Chronicle of Philanthropy*, 46. Volume XXV, No. 13, page 1.

47. Ibid.

48. Ibid., page 21.

49. The F.B. Heron Foundation, Program-Related Investment Portfolio Active for Year Ending 2011. Available at <http://www.fbheron.org/documents/pre-2012-pri-portfolio.pdf>.

50. \$40 Million Northwest Louisiana Community Development Fund I—A Mission-related Investment Opportunity. Available at [http://www.riverscapeparkway.com/images/Fund\\_Summary.pdf](http://www.riverscapeparkway.com/images/Fund_Summary.pdf).

51. Sonen Capital and KL Felicitas, Evolution of an Impact Portfolio: From Implementation to Results, October 2013. Available at <http://www.sonencapital.com/evolution-of-impact.php>.

52. Ibid., page 52.

53. KL Felicitas Foundation, Thematic Investments. Available at [http://www.klfelicitasfoundation.org/index.php/impact\\_investing/strat\\_mri/](http://www.klfelicitasfoundation.org/index.php/impact_investing/strat_mri/) (accessed October 2013).

criteria or employ exclusionary screens, mostly in public equities and fixed income. In identifying potential investments, KL Felicitas gives preference to funds and companies that have been rated by the Global Impact Investing Rating System (GIIRS).

**Wallace Global Fund:** In 2009, prompted by a desire to align mission and investments, the Wallace Global Fund's board and staff, under the leadership of new executive director Ellen Dorsey, decided to re-evaluate the foundation's investment policies and practice. The board and staff examined environmental, human rights and corporate accountability issues, and eventually adopted a new investment model that centered on a comprehensive sustainable and responsible investment strategy. Working with its investment advisor, RBC's SRI Wealth Management Group, Wallace Global hired 13 new investment managers that could apply those policies and let go of several investment managers that could not. A pleasant surprise for Wallace Global after changing the line-up of its investment managers was that it realized very substantial annual savings in fees.

The Wallace Global Fund's mission is to support environmental sustainability, social justice and a sound corporate system. Dorsey believes that there should be no "wall" between a foundation's 5 percent charitable allocation requirement and the remaining assets in terms of mission alignment. The endowment, now 100 percent mission-aligned across all asset classes, employs negative, positive and best-of-class screening. Some of the screens relate to social movements and human rights issues. The endowment is also more than 99 percent divested from fossil fuel companies, and the Fund expects to be 100 percent divested in 2014. It holds 10 percent of its investments in the clean tech sector, and Dorsey says the overall performance record of this segment has been excellent. Furthermore, 5 percent of the endowment is set aside for impact investments, with priorities on women and sustainable technologies, and a geographic interest in Africa.

**Foundations and the fossil fuels debate:** The swelling debate about climate risk and whether to divest from fossil fuel companies has led some foundations to consider the place of fossil fuels in their investments. Dorsey indicates that there is growing interest from philanthropic institutions to migrate their investments from fossil fuels and into innovative and sustainable energy alternatives. In January 2014 a group of foundations with combined assets over \$1.5 billion announced their commitment to divest from fossil fuels and invest in climate solutions. In addition to their own commitment, this diverse group of foundations called upon the philanthropic sector to have a dialogue about climate change risks in their portfolios and whether philanthropic assets are contributing to or retarding the transition to a new energy economy.

The Jubitz Family Foundation, which has program areas in early childhood development and education, peacemaking activities and environmental stewardship, committed in 2013 not only to divesting from fossil fuels, but also to prohibiting any investments in carbon-intensive industries. To weigh its options, it engaged the services of investment advisor CTC Consulting, which found that "carbon divestment would result in an insignificant impact on risk and return."<sup>54</sup> Similarly, the Educational Foundation of America has committed to divesting from all fossil fuel assets by 2014, and to reinvesting in clean technologies. The Russell Family Foundation recently decided to divest from 15 large coal companies.<sup>55</sup>

54. Jamie Henn, *Jubitz Family Foundation Divests Portfolio of Carbon*, *Fossil Free*, June 13, 2013. Available at <http://gofossilfree.org/jubitz-family-foundation-divests-portfolio-of-carbon/>.

55. Richard Woo, *The Russell Family Foundation and Coal Divestiture*, *Mission Investors Exchange*, July 2013. Available at [https://www.missioninvestors.org/node/1201/?utm\\_source=Mission+Investors+Exchange+Newsletter&utm\\_campaign=58247283d0-July\\_2013\\_Newsletter7\\_29\\_2013&utm\\_medium=email&utm\\_term=0\\_ec234af8f1-58247283d0-44898237](https://www.missioninvestors.org/node/1201/?utm_source=Mission+Investors+Exchange+Newsletter&utm_campaign=58247283d0-July_2013_Newsletter7_29_2013&utm_medium=email&utm_term=0_ec234af8f1-58247283d0-44898237).

Blue Moon Fund, a foundation based in Charlottesville, Virginia, that seeks “to protect landscapes and livelihoods threatened by climate change,” also considers climate issues throughout its portfolio. However, it has decided against divestment. Jason Green, the chief investment officer, says preliminary investment research suggests that over a market cycle, divesting completely of fossil fuels will not affect risk-adjusted returns materially. However, Blue Moon Fund agrees with the approach taken by Trillium Asset Management, one of its investment managers, of holding positions in select fossil fuel companies that demonstrate best practices while being active owners and engaging in shareholder advocacy to improve the ESG practices of all corporations. (Shareholder engagement is discussed in the next chapter.)

**Other foundations engaged in mission-related investing:** A few other foundations have committed a significant portion of their assets to mission-related investing. One is the Swift Foundation. Based in Santa Barbara, California, the foundation supports biological and cultural diversity. Its values include community participation, cultural autonomy, resilient systems, and transparency and accountability. It currently allocates 30 percent of its endowment to mission-related investing. For example, it invested \$500,000 in the WilderHill Clean Energy ETF Fund,<sup>56</sup> which is based on an index comprised primarily of companies in the sectors of greener utilities, power delivery and conservation, renewable energy supplies, cleaner fuels, energy conversion, and energy storage. Other mission-related investments are in equities, loans and private investment funds.

The Cordes Foundation, founded in 2006, has over 30 percent of its investment portfolio in impact investments. Target areas include education and the empowerment of women and girls, health care and job creation. According to Cordes, “during the financial crisis in 2008, the best performing investments in our portfolio were our impact investments—which were largely uncorrelated with the global turmoil ravaging the financial markets.”<sup>57</sup>

The Needmor Fund was one of the earliest adopters of sustainable and responsible investing activities, beginning in the early 1990s. Both positive and exclusionary screens are used for 90 percent of its assets. The Needmor Fund harnesses its investments to advance its mission: “to work with others to bring about social justice.” It uses screens for human rights, employee relations, community relations, product quality, the environment, energy and weapons production, and seeks to invest in companies that are accountable to their employees, consumers, the surrounding community and other stakeholders. Frank Sanchez, the executive director, explains that today the Needmor Fund’s SRI activities are largely smooth sailing because of the development of the appropriate internal infrastructure, support of expert investment managers, and years of practice. He also notes the foundation’s strong financial returns, stating: “Financial returns are as good as any foundation that doesn’t do [responsible investing].”<sup>58</sup>

The Park Foundation, located in New York and dedicated to education, public broadcasting and the environment, is also making a major commitment to “socially responsible investing.” With the help of RBC SRI Wealth Management Group, Park Foundation has moved virtually 100 percent of its portfolio into SRI vehicles. In addition, the foundation has allocated up to 1 percent of its portfolio value for PRIs.<sup>59</sup>

56. Swift Foundation, Current MRI Investments. Available at <http://swiftfoundation.org/sf-green-investing/current-mri-investments/> (accessed October 2013).

57. Cordes Foundation, What is Impact Investing—and why we are passionate about it. Available at <http://www.cordesfoundation.org/what-is-impact-investing-and-why-are-passionate-about-it/> (accessed October 2013).

58. Interview with Frank Sanchez, Executive Director of Needmor Fund, October 7, 2013.

59. The Park Foundation, Mission-Related Investing. Available at <http://parkfoundation.org/missionrelatedinvesting.html> (accessed October 2013).

***“During the financial crisis in 2008, the best performing investments in our portfolio were our impact investments—which were largely uncorrelated with the global turmoil ravaging the financial markets.”***

—CORDES FOUNDATION

## Program-Related Investment

While the focus of this paper is on how foundations can apply ESG and mission-related criteria across their invested endowments, PRIs deserve mention because they are often the first step foundations take to consider ESG criteria in their investments, and the process usually requires removing the barriers that place program officers and investment officers in separate silos.

The Internal Revenue Service stipulates that for an investment to be categorized as a PRI, it must meet the following three conditions:

1. The primary purpose is to accomplish one or more of the foundation’s exempt purposes,
2. Production of income or appreciation of property is not a significant purpose, and
3. Influencing legislation or taking part in political campaigns on behalf of candidates is not a purpose.

Although PRIs can be designed to produce at market, above market, or below market financial returns, the IRS stipulates that: “They must be investments that would not have been made except for their relationship to the exempt purposes.”<sup>60</sup>

A study by the Indiana University Lilly Family School of Philanthropy and data from the Foundation Center has found that fewer than 1 percent of foundations in the United States made PRIs each year over the past two decades.<sup>61</sup> In 2007, foundations made 125 PRIs, but the number of PRIs dipped below 100 annually in 2008 and 2009 during the financial crisis.<sup>62</sup> In 2011 the number of PRIs bounced back to 131.<sup>63</sup> In 2009, \$701 million in PRIs were made, compared with \$139 million in 1990. Housing, community development and education accounted for 66.5 percent of the number of PRIs and about 68 percent of PRI dollars between 2000 and 2010.

Many of the largest foundations are pursuing PRIs. In 2009 the Bill & Melinda Gates Foundation allocated \$400 million for its PRI initiative, and then expanded this amount to \$1 billion in 2012 to support its mission areas of education, health and international development.<sup>64</sup> The Ford Foundation manages a PRI allocation of \$280 million, comprising long-term loans and equity investments, that are concentrated in affordable housing, livelihood development, and the provision of financial services.<sup>65</sup> The David and Lucile Packard Foundation has made program-related investments since the 1980s and currently allocates \$180 million for PRIs.

60. U.S. Internal Revenue Service, Program-Related Investment. Available at <http://www.irs.gov/Charities-&-Non-Profits/Private-Foundations/Program-Related-Investments> (accessed October 2013).

61. The Non-profit Times, *Foundations Not Making Many Program-Related Investments*, May 21, 2013. Available at <http://www.thenonprofitimes.com/news-articles/foundations-not-making-many-program-related-investments/>.

62. Ibid.

63. Steven Lawrence and Reina Mukai, Key Facts on Mission Investing, Foundation Center, October 2011. Available at [http://foundationcenter.org/gainknowledge/research/pdf/keyfacts\\_missioninvesting2011.pdf](http://foundationcenter.org/gainknowledge/research/pdf/keyfacts_missioninvesting2011.pdf).

64. Nicole Wallace, “The Gates Foundation Reveals How It Makes Program-Related Investments,” *Chronicle of Philanthropy*, April 5, 2011. Available at <http://philanthropy.com/blogs/conference/the-gates-foundation-reveals-how-it-makes-program-related-investments/27772>.

65. Impact Reporting and Investment Standards, The Ford Foundation—PRI Fund. Available at <http://iris.thegiin.org/ford-foundation-pri-fund> (accessed October 2013).

The John D. and Catherine T. MacArthur Foundation (MacArthur Foundation) has been making PRIs since 1986, and its active PRI portfolio today is almost \$300 million. It typically structures PRIs as 10-year notes with 1 to 2 percent interest, and uses them to support community development and the preservation of affordable rental housing.

The MacArthur Foundation has made approximately \$125 million in PRIs since the early 2000s for housing preservation for low-income individuals and families, helping developers to preserve 80,000 affordable rental homes as of year-end 2011.<sup>66</sup>

Over the next few years, the MacArthur Foundation plans to make \$25 million in PRIs for deep energy-efficiency retrofits in low-income multi-family housing units. These improvements will create healthier buildings, reduce utility bills for tenants and foster job creation by employing local contractors and backing new social enterprises working in this area.

While the MacArthur Foundation has not made mission-related investments yet, its board is considering it. As the energy efficiency program develops, MRIs appear to be an appropriate investment approach for some aspects of the program, according to MacArthur Foundation program officer Mijo Vodopic.

## Community Investment

Community investment is a relatively broad sector that comprises a variety of investment vehicles and social outcomes ranging from concessionary loans and equity investments in nonprofit community groups to market-rate investments in for-profit real estate development. The level and focus of community benefits created by these investments will vary depending upon asset class, geographical region and community need. All community investments share three core characteristics that unify them into a distinct strategy for mission-driven investors:

- 1) A focus on marginalized areas or communities that conventional market activity does not reach (in practice, low-income neighborhoods or regions, communities of color, and underserved geographic regions such as rural communities);
- 2) A focus on enabling the delivery of explicit social benefits (affordable housing, economic development, provision of needed goods and services at affordable rates, healthier outcomes) to those areas or communities; and
- 3) A financial product available for investment that can be managed in terms of risk and return.

By one definition—the combined assets of US banks, credit unions, loan funds and venture capital funds certified as CDFIs, of US-based microfinance funds and of US credit unions dedicated to serving low- and moderate-income communities—community investments totaled \$61.4 billion at year-end 2011 compared with \$41.7 billion at the end of 2009.<sup>67</sup>

Private equity investments can also be suitable for community investing. Private equity can offer the advantage of more narrowly tailoring strategies to particular mission areas for foundations that may have some flexibility in their return expectations.

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66. MacArthur Foundation, *Brochure: Window of Opportunity: Preserving Affordable Rental Housing*, June 5, 2007. Available at <http://www.macfound.org/press/publications/brochure-window-of-opportunity-preserving-affordable-rental-housing/>.

67. US SIF Foundation, *2012 Report on Sustainable and Responsible Investing Trends in the United States*, page 41.



Private foundations have long played a vital role in supporting community investment. They have made intermediary grants to support community investment lending, engaged in program-related investing in community development finance institutions, and invested at market rate in equity and debt vehicles that provide capital to marginalized communities. For example, the Mary Reynolds Babcock Foundation is an active community investor that makes PRI investments in credit unions, banks, revolving loan funds and venture capital funds certified as CDFIs.<sup>68</sup> The foundation's PRIs are usually in the form of insured deposits or loans to revolving loan funds.<sup>69</sup> Some current investment holdings are in Generations Community Credit Union, Hope Federal Credit Union, Latino Credit Union and Lowcountry Housing Trust.<sup>70</sup> The Annie E. Casey Foundation makes mission-related deposits to CDFIs, such as credit unions, and they are typically structured as share certificates or certificates of deposit.<sup>71</sup>

Because foundations generally have specific mission areas, such as education or the environment, they can use sectoral approaches to channel community investments. Many foundations have turned their focus towards healthcare delivery to marginalized communities as a developmental goal. Community investments in this sector include investment in healthcare clinics and other service provisions to underserved communities under its broader umbrella. Other sectors that have emerged within the community investment field are fresh foods and sustainable agriculture and equitable transit-oriented development. The latter refers to "smart growth" that enhances denser, walkable, mixed-use, mixed-income communities near mass transit.

The California Endowment and the Kresge Foundation are championing

Examples of Foundations Involved in Community Investing		
FOUNDATION	TOTAL ESTIMATED ASSETS (MILLIONS \$)	AS OF YEAR-END
Annie E. Casey Foundation	\$2,670	2011
California Endowment	\$3,660	2012
Cedar Tree Foundation	\$95	2011
Christopher Reynolds Foundation	\$24	2012
Cordes Foundation	\$11	2012
Edward W. Hazen Foundation	\$21	2011
F.B. Heron Foundation	\$241	2011
Ford Foundation	\$11	2012
John D. and Catherine T. MacArthur Foundation	\$5,700	2011
KL Felicitas Foundation	\$10	2011
Kresge Foundation	\$3,030	2011
Mary Reynolds Babcock Foundation	\$162	2012
Nathan Cummings Foundation	\$403	2011
Needmor Fund	\$23	2011
Swift Foundation	\$52	2012
W.K. Kellogg Foundation	\$7,260	2012
Wallace Global Fund	\$148	2011
<i>Note: This is a sample, rather than a comprehensive list, of private foundations engaging in community investing. The value of total assets under management is drawn from 990 forms and other public sources as of the years indicated.</i>		

68. Mary Reynolds Babcock Foundation, Program-Related Investments. Available at <http://mrbf.org/program-related-investments> (accessed October 2013).

69. Ibid.

70. Mary Reynolds Babcock Foundation, Our PRIs. Available at <http://mrbf.org/our-pris> (accessed July 2013).

71. The Annie E. Casey Foundation, Social Investments. Available at <http://www.aecf.org/OurWork/CommunityChange/SocialInvestments.aspx> (accessed October 2013).

healthy foods, affordable housing and health services for low-income communities, and urban revitalization. Their efforts are strong examples of the impact that private foundations can achieve through community investing.

**The California Endowment:** The California Endowment is a private health foundation dedicated to expanding affordable, quality health care in California. While the Endowment applies a tobacco restriction across its whole portfolio, it also has explored mission-aligned impact investments that have accounted for 2 to 5 percent of the assets. Tina Castro, the Endowment's director of impact investing, prefers to use "impact" to describe this approach since, with some of the structured funds involved, it is difficult to determine the appropriate benchmark and thus whether the vehicle in question is achieving market returns. These impact investments technically are program-related investments, but the California Endowment meets its 5 percent payout requirement through grantmaking.

Many of the Endowment's programs seek to tackle the causes of poor health by focusing on diet, exercise and preventive health care. In 2011, the Endowment, with several partners, launched the California FreshWorks Fund, a public-private loan fund that encourages grocery stores and other fresh food retailers to establish or grow businesses in underserved communities to increase access to healthy foods at affordable prices.<sup>72</sup> The fund also supports innovative business models such as farmers markets, cooperatives and produce trucks.

Seeded with a \$30 million debt investment and a \$3 million grant from the California Endowment, the fund has raised over \$270 million from healthcare organizations, grocery industry groups, banks and others, of which \$40 million has been deployed for approximately 17 projects. The California Endowment and its partners also hope that the fund will foster economic development and job creation; fund officials say the financing should be sufficient to help create or retain an estimated 6,000 jobs in California.<sup>73</sup>

**The Kresge Foundation:** The Kresge Foundation, headquartered in Detroit, is an investor in community development, particularly in the health services sector. One component of its mission is "creating access and opportunity in underserved communities" and "improving the health of low-income people."<sup>74</sup> Five years ago, Kresge began making program-related investments alongside its grantmaking activities. In 2012, the foundation contributed towards a \$100 million investment fund, the Healthy Futures Fund, with a \$6 million loan alongside a \$31 million grant, while Morgan Stanley provided the remaining \$63 million. The fund, which benefits from using federal Low Income Housing Tax Credit equity and federal New Markets Tax Credit enhanced loan capital,<sup>75</sup> is "designed to spur collaboration among healthcare providers and housing developers who do not often work together even when they operate in the same low-income neighborhoods and serve the same people."<sup>76</sup> Using the fund, the partnership plans to build 500 housing units that will be integrated with health services. Plans for seven to eight new Federally Qualified Health Centers are also in the pipeline, which are estimated to support approximately 75,000 people and generate 1,200 permanent jobs and 200 temporary jobs.<sup>77</sup>

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72. Tanishia Wright, *The California Fresh Works Fund Launch!* Community Health Councils, Inc. Available at <http://www.chc-inc.org/california-fresh-work-fund-> (accessed October 2013).

73. P.J. Huffstutter, "Grocery store financing program to be announced," *Los Angeles Times*, July 20, 2011. Available at <http://articles.latimes.com/print/2011/jul/20/business/la-fi-grocery-loans-20110720>.

74. The Kresge Foundation, Mission and Values. Available at <http://kresge.org/about-us/mission-values> (accessed October 2013).

75. Healthy Futures Fund. Available at <http://www.newmarkets.org/docs/HFF%20Summary%203-12-13.pdf>.

76. The Kresge Foundation, *\$100 million investment fund to integrate health care, affordable housing in low income communities*, January 14, 2013. Available at <http://kresge.org/news/100-million-investment-fund-integrate-health-care-affordable-housing-low-income-communities>.

In addition, the Kresge Foundation with NCB Capital Impact, a CDFI, recently launched a \$30.25 million fund to support Detroit, which filed for bankruptcy in July 2013. The fund, called the Woodward Corridor Investment Fund, extends long-term fixed-rate loans for the redevelopment of Detroit's Woodward Corridor.<sup>78</sup> The fund will support mixed-use, mixed-income, transit-oriented projects to attract residents and businesses and spur economic activity in the area. Other supporters of the fund are Calvert Foundation, Living Cities, Max M. & Marjorie S. Fisher Foundation, MetLife, PNC Bank and Prudential.

## Alternative Investment

An increasing share of private foundations ventured into alternative investments between 2008 and 2011 as a part of their diversification strategies, according to a Foundation Source study analyzing the activities of US foundations with less than \$50 million in assets under management (which constitute 98 percent of all US private foundations). In 2011, 80 percent of foundations with assets between \$10 million and \$50 million employed alternative investment strategies, compared with 72 percent in 2008. Smaller foundations, with assets between \$1 million and \$10 million, witnessed a more significant jump: 60 percent of these foundations made investments in alternative strategies as of year-end 2011 versus only 42 percent as of year-end 2007.<sup>79</sup> On average, the asset allocation to alternative investments stayed at about the same level of 14 percent of assets throughout the same period.<sup>80</sup>

Alternative fund managers are at the same time increasingly incorporating ESG strategies into their investment vehicles, presenting more options for foundations interested in mission investing. In 2012, the US SIF Foundation identified over 300 alternative investment vehicles considering ESG criteria, including private equity and venture capital funds, property funds and hedge funds, with total assets of \$132 billion. In 2010, the US SIF Foundation had identified just \$37.8 billion in ESG alternative investment vehicles.<sup>81</sup>

Opportunities for foundation investment in ESG alternative investments vary by asset class. In 2012, the US SIF Foundation tracked 175 private equity and venture capital funds with \$57 billion in ESG assets under management, many focused on cleantech and renewable energy or responsible community investment. Leading ESG criteria for private equity and venture capital funds are pollution/toxics (\$35.17 billion), labor—for example high quality job creation (\$31.08 billion) and sustainable natural resources/agriculture (\$30.08 billion).

Property funds range widely from direct investments in “hard assets,” such as developed commercial and residential property, farms and forests or undeveloped land, to more indirect investments in property-related instruments such as Mortgage-Backed Securities (MBS), structured financial products derived from MBS, other pools of debt, or equity portfolios of properties managed through Real Estate Investment Trusts (REITs). As of 2012, 84 property funds managed almost \$70 billion around environmental, social and corporate governance themes. The top ESG criteria included green building and smart growth (\$63.32 billion), labor—for example labor-friendly contracting (\$60.88 billion), and sustainable community development (\$46.19 billion).

77. Healthy Futures Fund. Available at <http://www.newmarkets.org/docs/HFF%20Summary%203-12-13.pdf>.

78. The Kresge Foundation, *NCB Capital Impact and Kresge launch innovative Woodward Corridor Investment Fund*, September 15, 2013. Available at <http://kresge.org/news/ncb-capital-impact-and-kresge-launch-innovative-woodward-corridor-investment-fund>.

79. Data includes distressed debt and commodities, but most of the foundations in the study group held alternative assets in limited partnership interests, real estate and other real property. Foundation Source, *First Annual Report on Private Foundations*, 2012, page 17. Available at [http://www.foundationsource.com/resources/FS\\_2012\\_Annual\\_Report.pdf](http://www.foundationsource.com/resources/FS_2012_Annual_Report.pdf).

80. Ibid, page 3.

81. US SIF Foundation, *2012 Report on Sustainable and Responsible Investing Trends in the United States*, page 13.

ESG hedge funds currently represent a smaller pool of assets, calculated at \$5.3 billion by the US SIF Foundation as of 2012. However, due to the limited transparency of hedge funds, this is a conservative estimate. Most of the capital, up to \$4 billion, is deployed across environmental themes. According to global consulting firm Mercer, hedge funds are one of the asset classes that has “proven the most difficult for managers to integrate ESG issues...due to a lack of consensus on how ESG factors should be applied to some hedge fund strategies, particularly those that are high turnover, trading-based strategies.”<sup>82</sup> However, more

## Examples of Foundations with ESG Alternative Investments

FOUNDATION	TOTAL ESTIMATED ASSETS (MILLIONS \$)	AS OF YEAR-END
Annie E. Casey Foundation	\$2,670	2011
Bill & Melinda Gates Foundation	\$34,640	2011
Blue Moon Fund	\$161	2011
California Endowment	\$3,660	2012
Cedar Tree Foundation	\$95	2011
David and Lucile Packard Foundation	\$5,800	2011
Educational Foundation of America	\$141	2011
F.B. Heron Foundation	\$241	2011
Hull Family Foundation	\$22	2011
Jessie Smith Noyes Foundation	\$42	2011
KL Felicitas Foundation	\$10	2011
Park Foundation	\$335	2011
Rockefeller Foundation	\$3,510	2011
Russell Family Foundation	\$129	2011
Skoll Foundation	\$472	2011
W.K. Kellogg Foundation	\$7,260	2012
Wallace Global Fund	\$148	2011

*Note: This is a sample, rather than a comprehensive list, of private foundations with ESG alternative investments. The value of total assets under management is drawn from 990 forms and other public sources as of the years indicated.*

research and dialogue is focusing on hedge funds and ESG strategies. In 2011 the Principles for Responsible Investment formed a hedge funds work stream for its members. The Educational Foundation of America is currently working with its investment manager to create the first fossil fuel-free and ESG-screened hedge fund.<sup>83</sup>

For the largest foundations in the United States, efforts to align charitable goals with alternative investment strategies, either as PRIs or MRIs, are still in the early stages. However, some of the foundations that have sought such alignment are the Bill & Melinda Gates Foundation, the David and Lucile Packard Foundation and the W.K. Kellogg Foundation. For example, the Gates Foundation in early 2011 made its first direct equity investment, a \$2 million PRI, in for-profit education technology company Ingral. The foundation also directs venture investments in the life sciences sector as part of its focus on global health and development.<sup>84</sup>

**W.K. Kellogg Foundation:** As noted earlier, private equity, venture capital and real estate funds can be directed towards community investing. The W.K. Kellogg Foundation, established in 1930 by the breakfast cereal inventor, Will Keith Kellogg, to promote the education, shelter, health and general welfare of

82. Jane Ambachtsheer and Katherine Burstein, *Mercer's ESG Ratings Update—5,000 and Counting*, Mercer, August 12, 2013. Available at <http://www.mercer.com/articles/ESG-ratings-update> (accessed October 2013).

83. Principles for Responsible Investment, *Hedge Funds*. Available at <http://www.unpri.org/areas-of-work/implementation-support/hedge-funds/> (accessed October 2013).

84. Ron Leuty, “VC Bob More takes shot at Gates Foundation venture role,” *San Francisco Business Times*, July 30, 2013. Available at <http://www.bizjournals.com/sanfrancisco/blog/biotech/2013/07/bob-more-gates-foundation-life-sciences.html?page=all>.

children, is one example of this approach. With an endowment of almost \$8 billion, more than 50 percent of which is invested in Kellogg Company, the foundation is one of the 10 largest in the United States by asset size.

Five years ago, the W.K. Kellogg Foundation allocated \$100 million for what it calls Mission Driven Investments (MDIs). Tony Berkley, director of Mission Driven Investments at the foundation, describes MDIs as market-rate impact investments predominantly within private markets. The focus is on vulnerable children in the areas of education, health, food and nutrition, as well as alternative financial services for low-income communities. Imprint Capital Advisors partners with the foundation in its mission driven investment work.

Eighty percent of the capital has already been committed, and investments so far have been made primarily in private equity. Segmentation by asset class consists of private equity (\$56.3 million), fixed income (\$16.3 million), and cash deposits (\$7.08 million).<sup>85</sup> Berkley says that the foundation is particularly interested in direct investments; it has made six direct investments totaling \$21.1 million and exited two: Wireless Generation, an educational technology company now called Amplify, was acquired by News Corp in December 2010, and Happy Family, a producer of organic and nutritious foods, was recently acquired by Danone.

**Foundations pursuing environmentally themed alternatives:** Environmental issues are another popular target of alternative investment funds. One foundation active in this area is the Blue Moon Fund, which has assembled a mission-aligned portfolio of private investments in venture capital, growth equity, project finance, real assets and private debt. One of Blue Moon's holdings is Ecosystem Investment Partners II LP, whose stated goal is to "preserve the natural environment and restore environmental degradation by acquiring, restoring and protecting large rural properties that generate significant, current cash flow through the sale of wetland, stream, and endangered species mitigation bank credits."<sup>86</sup>

Several foundations, including Annie E. Casey, F.B. Heron, Hull Family, Jessie Smith Noyes, Park and Wallace Global Fund, are investors in the SJF Ventures III Fund, which closed in April 2013. SJF Ventures, a venture capital partnership, makes investments in the "resource efficiency, sustainability and technology-enhanced service sectors."<sup>87</sup> Specific investment areas include education technology, health and wellness technology, sustainable agriculture and food safety, efficiency and infrastructure, and asset recovery including reuse and recycling.<sup>88</sup>

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85. W.K. Kellogg Foundation, MDI Overview. Available at <http://mdi.wkkf.org/our-mission/overview.aspx#2> (accessed October 2013).

86. Blue Moon Fund, Mission Impact Investments. Available at <http://www.bluemoonfund.org/investing/current-mission-impact-investments/> (accessed October 2013).

87. SJF Ventures, *SJF Ventures Announces Close of Third Fund at \$90M, 3x Prior Fund Size*, May 1, 2013. Available at <http://www.sjfventures.com/sjf-announces-close-of-third-fund-at-90m-3x-prior-fund-size>.

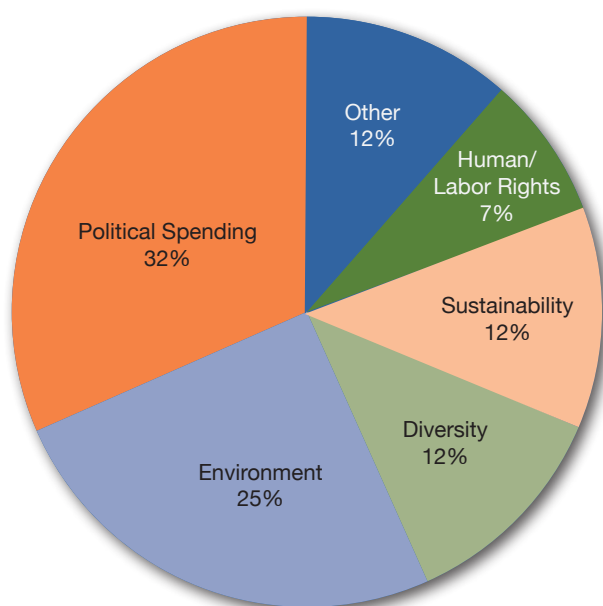
88. SJF Ventures, About SJF Ventures. Available at <http://www.sjfventures.com/about> (accessed October 2013).



### 3. Putting Responsible Investing Strategies to Work: Shareholder Engagement

Owning shares in a company gives investors a channel through which to improve corporate accountability. Shareholder engagement is an opportunity for foundations to influence corporate behavior to address environmental, social and corporate governance issues that are areas of concern for responsible investors. Through such engagement, foundations can draw attention to ESG issues that their portfolio companies might otherwise neglect, help to ensure that companies address obligations to the society in which they operate and protect long-term shareholder value.

**ESG Proposals Filed by Foundations and Other Investors for 2013 Proxy Season**



Source: Sustainable Investments Institute.  
Note: Political spending category includes lobbying.

Between 2010 and 2012, at least 13 foundations filed or co-filed shareholder resolutions on ESG issues,<sup>89</sup> and at least 12 filed or co-filed in the 2013 annual meeting season.<sup>90</sup> Several other foundations, while not filing shareholder resolutions in their own names, have deliberately chosen to invest in SRI equity strategies whose managers are active in communicating with companies and filing resolutions on ESG issues; some engage the services of As You Sow, an organization that represents investor clients in engagement with corporate executives on environmental and human rights issues. To save time and resources, many foundations rely on shareholder advocacy coalitions with other investors to lead collaborations. A list of some of these coalitions can be found in the resources section at the end of this report.

A diverse array of investors filed more than 400 resolutions relating to environmental, social and key corporate governance issues for the 2013 annual meeting season, and 393 such resolutions in 2012.<sup>91</sup> The dominant issues of the recent seasons correspond to important issues of concern for foundations.

The top issue by far is corporate political spending and lobbying. The number of resolutions filed on this subject rose to more than 100 a year beginning in 2011, up from an annual average of about 60 in 2007 through 2010, as shareholders reacted to the US Supreme Court's *Citizens United* decision removing

89. US SIF Foundation, *2012 Report on Sustainable and Responsible Investing Trends in the United States*, pages 109–110.

90. Interfaith Center on Corporate Responsibility, *2013 Proxy Resolutions and Voting Guide*. Available at <http://www.iccr.org/publications/index2.php>.

91. Sustainable Investments Institute press release, *2013 Season Poised to Break Records in Filings*, August 20, 2013. Available at [http://siinstitute.org/press/2013/08202013\\_Si2\\_Press\\_Release\\_Proxy\\_Review\\_FINAL.pdf](http://siinstitute.org/press/2013/08202013_Si2_Press_Release_Proxy_Review_FINAL.pdf).



restrictions on corporate political advertising and spending. In 2013, the number of resolutions filed on political spending and lobbying jumped to 125.<sup>92</sup>

Other key issues raised in recent shareholder resolutions are sustainable governance and reporting, climate change and other environmental issues, and diversity, which together accounted for nearly 50 percent of the filed resolutions tracked by the Sustainable Investments Institute.

As outlined earlier in the report, foundations can file or co-file shareholder resolutions, actively vote their proxies, engage in dialogue with corporate management or join shareholder coalitions as a means to encourage companies to improve their environmental, social and corporate governance practices. In addition, investors can participate in public policy initiatives, engage with government regulatory agencies and testify and report on ESG investment issues to Congress. The following sections detail different shareholder engagement strategies, specific foundation activities in these areas, and the ESG issues that have garnered significant attention.

## Filing and Co-Filing Shareholder Resolutions

Institutional investors who continuously own shares worth at least \$2,000 in any US listed company for the year prior to the company's annual submission deadline can file or co-file shareholder resolutions for a vote at the company's annual general meeting. Shareholder resolutions that meet various guidelines established by the US Securities and Exchange Commission (SEC) will be included in the company's proxy statement, the annual meeting agenda it mails to all company shareholders. For foundations that are beginning to explore the possibility of filing shareholder resolutions, co-filing with other investors is a good way to learn the process.

A shareholder resolution need not win majority support to be eligible for resubmission. Under the rules of the SEC, a resolution must get the support of at least 3 percent of the shares voted the first year, 6 percent the second year, and 10 percent the third year and years going forward. By keeping issues on the proxy ballot over multiple years, shareholders have more time to draw attention to their causes and raise votes.

It is rare for shareholder resolutions on ESG issues to win the support of the majority of shares voted at company annual meetings. Moreover, most shareholder resolutions filed are non-binding, meaning that even if they gain a majority of votes, the company need not comply with their requests. Despite these constraints, filing shareholder resolutions can achieve important successes. Resolutions that win 10 percent or more of the shares voted demonstrate that a significant segment of shareholders supports the resolution and that it has enough support to be resubmitted year after year.<sup>93</sup> This is especially true when a corporation's management owns a significant portion of the shares, leaving outside shareholders a smaller portion of shares to work with. More importantly, shareholder resolutions bring important issues to light, often influencing companies to make policy changes. Companies will sometimes resolve issues in shareholder resolutions before they come to vote, leading to a withdrawal of the resolution by the filer.

The shareholder advocacy of the Education Foundation of America (EFA), active in the program areas of environment, reproductive health and justice, and arts and education, is instructive. EFA has been involved with shareholder advocacy since 1996, working closely over this period with As You Sow, which has represented EFA's shares in filing resolutions and engaging in dialogue with corporate managements.

92. As You Sow, Proxy Impact, Sustainable Investments Institute, *2013 Proxy Preview: Helping Shareholders Vote their Values*, page 6. Available at <http://www.proxypreview.org/> (accessed October 2013).

93. Interfaith Center on Corporate Responsibility, *2013 Proxy Resolutions and Voting Guide*, page 6. Available at <http://www.iccr.org/publications/index2.php>.

With As You Sow, EFA has had a number of significant victories. In 2013, McDonald's agreed to stop using environmentally damaging polystyrene foam cups at 14,000 stores in the United States after a shareholder resolution that As You Sow filed on EFA's behalf in 2011 won 30 percent support. According to As You Sow Senior Vice President Conrad MacKerron, EFA and As You Sow are encouraging McDonald's to incorporate recycled material into their paper cups and to establish onsite recycling systems for food packaging waste.<sup>94</sup> Other shareholder resolutions filed by EFA and As You Sow have led to Coke, Pepsi and Nestle Waters recycling 18 billion plastic bottles every year; to Apple, Best Buy, Dell and Hewlett-Packard recycling 500,000 tons of electronic waste annually; and to a major recycling initiative by Starbucks.

The Needmor Fund has also seen positive changes result from its shareholder engagement and advocacy. The foundation has filed and co-filed a number of shareholder resolutions, and executive director Frank Sanchez cites Walden Asset Management as providing significant support in these activities. Moreover, when grantees raise issues of concern regarding a company, the foundation considers and often uses shareholder engagement as a means to support workers' rights, environmental sustainability and corporate accountability.

A decade ago, The Needmor Fund seized a unique opportunity to leverage its assets for mission-related social impact through shareowner advocacy by working with a grantee to help improve the fast-food industry. Since 2001, one of the Fund's grant recipients, the Florida-based Coalition of Immokalee Workers, had engaged in a campaign to reform the working conditions of farmworkers who picked tomatoes for Taco Bell. As a foundation "seeking to empower traditionally disadvantaged populations," the Needmor Fund joined other concerned investors in co-filing several resolutions at Yum! Brands, Taco Bell's parent company, to hold the company accountable for its community relations.<sup>95</sup> After a four-year boycott against Taco Bell by the Coalition, large minority shareowner support for resolutions, and on-going efforts by investors to engage Yum! over these issues, the company agreed to a historic settlement with the Immokalee Workers in 2005. The agreement increased farmworker wages and applied a General Supplier Code of Conduct for growers across Florida. The settlement is providing tangible social benefits to a largely immigrant workforce and has helped the company mitigate risks of litigation or further damage to its reputation.

## Key Issues Raised by Shareholder Resolutions

Foundations, collaborating with other investors in shareholder campaigns, have also achieved successes related to corporate political spending, sustainability reporting and fair employment practice.

**Corporate political spending and lobbying:** As noted earlier, investor demands for disclosure and oversight of corporate political spending and lobbying expenditures now dominate the social issues proxy season. Concerned shareholders want companies to exercise proper oversight to ensure these payments serve the best interests of the firms and their shareholders and will not harm their reputations. The campaign on political spending has been led by the Center for Political Accountability (CPA) with the support of an investor coalition that includes pension funds, foundations, labor unions, environmental groups and sustainable investment managers. Since the start of the campaign in 2004, the CPA and its allies have persuaded more than 100 large companies, including more than half of the S&P 100, to disclose and require board oversight of their political spending with corporate funds.

94. Robert Kropp, McDonald's will ditch polystyrene for paper coffee cups, [Greenbiz.com](http://www.greenbiz.com/blog/2013/09/27/mcdonalds-use-paper-coffee-cups-after-shareholder-pressure), September 27, 2013. Available at <http://www.greenbiz.com/blog/2013/09/27/mcdonalds-use-paper-coffee-cups-after-shareholder-pressure>.

95. Needmor Fund, Investment Policy, May 2011. Available at <http://www.needmorfund.org/InvPol.pdf>.

## Examples of Private Foundations Filing or Co-Filing Shareholder Resolutions in 2013

FOUNDATION NAME	ISSUES RAISED	TOTAL ESTIMATED ASSETS (MILLIONS \$)
Brainerd Foundation	Adopting greenhouse gas reduction goals report, lobbying expenditures disclosure, sustainability reporting	\$28
Christopher Reynolds Foundation	Climate risk, lobbying expenditures disclosure, separate chair and CEO, sustainability reporting	\$24
Edward W. Hazen Foundation	Lobbying expenditures disclosure, sustainability reporting	\$21
Lemmon Foundation	Adopting greenhouse gas reduction goals report, lobbying expenditures disclosure, sustainability reporting	N/A
Max and Anna Levinson Foundation	Adopting greenhouse gas reduction goals report, lobbying expenditure disclosure, sustainability reporting	\$15
Merck Family Fund	Adopting greenhouse gas reduction goals report, lobbying expenditures disclosure, sustainability reporting	\$48
Nathan Cummings Foundation	Executive compensation based on sustainability principles, political contributions, prohibiting accelerated vesting, network neutrality	\$403
Needmor Fund	Adopting greenhouse gas reduction goals report, lobbying expenditure disclosure, political contributions, separate chair and CEO, sustainability reporting	\$23
Russell Family Foundation	Lobbying expenditures disclosure, sustainability reporting	\$129
Swift Foundation	Lobbying expenditures disclosure, sexual orientation non-discrimination, sustainability reporting	\$52
Wallace Global Fund	Sexual orientation non-discrimination, sustainability reporting, waste management	\$148

*Adapted from Interfaith Center on Corporate Responsibility: 2013 Proxy Resolutions and Voting Guide. The value of total assets under management is drawn from 990 forms and other public sources.*

One of the members of this coalition, The Nathan Cummings Foundation, has filed resolutions for several years at Valero Energy, a Fortune 500 company that manufactures and markets petrochemical products, regarding its political contributions and activities. The foundation first filed a shareholder resolution in 2008 with Valero Energy asking it to disclose its political contributions, and re-filed it in 2009. In its second year, the resolution won 47.4 percent of the vote, persuading Valero Energy to adopt a political contributions disclosure policy and provide contribution data on its website.

While pleased with this success, the foundation is now pushing Valero to disclose its dues and contributions to trade associations that engage in political activities. Shareholder support at Valero for this resolution grew from 27 percent in 2010 to 43 percent in 2013.<sup>96</sup>

96. Nathan Cummings Foundation, *Shareholder Resolutions from 2003 to 2012*. Available at <http://www.nathancummings.org/sites/default/files/Resolutions%20thru%206.20.12.pdf>.

**Sustainability reporting:** In recent years, shareholders, including some foundations, have asked firms to review the broad sustainability of their operations, not only in terms of their environmental impact, but also in how they address labor and community issues. Proponents have withdrawn the majority of sustainability reporting proposals they have filed in recent years, usually after successful negotiations with the target companies.

In 2013, for example, the Christopher Reynolds Foundation, Needmor Fund and Wallace Global Fund co-filed a shareholder resolution with Walden Asset Management asking Coherent, a technology company specializing in designing, manufacturing and marketing laser sources, tools and accessories, to issue a sustainability report addressing its ESG performance, including its greenhouse gas emissions and reduction targets. The filers pointed out while Coherent publicizes conservation goals on its website, they believed them to be “too general.”<sup>97</sup>

Noting in the resolution that over two thirds of the S&P 500 companies now report to CDP, which maintains the largest global database of primary corporate climate change information,<sup>98</sup> and that “over 80 percent of Global Fortune 250 companies produce sustainability reports,” the filers urged Coherent to meet these best practices. They added:

We believe tracking and reporting on ESG business practices makes a company more responsive to a global business environment which is characterized by finite natural resources, changing legislation, and heightened public expectations for corporate accountability. Reporting also helps companies: better integrate and gain strategic value from existing sustainability efforts, identify gaps and opportunities in products and processes, develop company-wide communications, publicize innovative practices and receive feedback.<sup>99</sup>

The investors were able to withdraw the shareholder resolution when Coherent agreed to address the issues in the proposal and continue further dialogue. In return, the filers agreed to not re-file the shareholder resolution for another three years.<sup>100</sup>

**Equal employment opportunity:** Over the past several years, shareholders, including public pension funds, foundations and sustainable and responsible investment firms, have been able to withdraw dozens of resolutions asking companies to pledge not to discriminate against employees based on their sexual orientation when the companies have agreed to expand their non-discrimination policies to include this guarantee. Shareholder proponents are aided in their negotiations with companies by the high levels of support such resolutions receive when they do go to votes.

In 2013, for example, the Swift Foundation and the Wallace Global Fund co-filed a resolution asking East West Bancorp to “amend its written equal employment opportunity policy to explicitly prohibit discrimination based on sexual orientation and gender identity or expression.”<sup>101</sup> Walden Asset management served as the lead filer, and other co-filers included the Tides Foundation (a public foundation) and Trillium Asset

97. Ceres Investor Network on Climate Risk, *Coherent Inc., Sustainability Report 2013*. Available at <http://www.ceres.org/investor-network/resolutions/coherent-inc.-sustainability-report-2013>.

98. See <https://www.cdp.net/en-US/Pages/HomePage.aspx>.

99. Ceres Investor Network on Climate Risk, *Coherent Inc., Sustainability Report 2013*. Available at <http://www.ceres.org/investor-network/resolutions/coherent-inc.-sustainability-report-2013>.

100. As You Sow, Proxy Impact, *Sustainable Investments Institute, 2013 Proxy Preview: Helping Shareholders Vote their Values*, page 55 <http://www.proxypreview.org/> (accessed October 2013).

101. Walden Asset Management, *Summary of Walden's 2013 Shareholder Resolutions*. Available at <http://www.waldenassetmgmt.com/LiteratureRetrieve.aspx?ID=158699>.

Management. The filers were able to withdraw the resolution when East West Bancorp agreed to modify its policies.<sup>102</sup> The same filers submitted a similar resolution to J2 Global Communications, and were also able to withdraw it with the agreement of J2 to amend its policies.<sup>103</sup>

## Actively Voting Proxies

Another effective activity for foundations is to actively vote their shares in publicly traded companies in a manner that reflects their philanthropic missions and concerns as long-term asset owners. The Jessie Smith Noyes Foundation, Nathan Cummings Foundation and Mary Reynolds Babcock Foundation post their proxy voting guidelines on their websites, including their voting policies towards ESG issues.

The proxy voting guidelines of the Jessie Smith Noyes Foundation are a part of its investment policy statement, which includes this paragraph describing its view of fiduciary duty: “We believe that in light of the social, environmental and economic challenges of our time, fiduciary responsibility in the coming decades will dictate the integration of prudent financial management practices with principles of environmental stewardship, concern for community, and corporate accountability to shareholders and stakeholders alike.” The proxy voting guidelines are as follows:

- When program interests are directly involved, proxies shall be voted in a manner consistent with them.
- When a shareholder resolution deals with a social or environmental issue that is not directly related to the Foundation’s program interests, the proxy shall be voted in a manner consistent with this Policy Statement. The Foundation will review each individual case and consult with our grantees, managers and others, as appropriate.
- On issues of corporate governance the Foundation will vote according to the following general guidelines:
  - Ratify Auditors
  - Ratify Directors unless governance or a program interest issue has been raised or there is a lack of diversity on the board
  - Vote against golden parachutes for executives
  - Vote for proposals requiring a majority of independent directors
  - Vote for proposals requiring nominating and/or compensation committees to be composed exclusively of independent directors
  - Vote for incentive payments that are tied to social and environmental performance
  - Vote for proposals recognizing the standing of stakeholders other than shareholders in governance and control.<sup>104</sup>

The Nathan Cummings Foundation’s proxy voting guidelines also detail its policies regarding specific ESG issues. A link to the guidelines can be found in the resources section at the end of this report.

In addition to voting shares owned directly in companies, investors are beginning to see some options to vote their shares owned in pooled funds through investment managers. For example, in August 2013 Merrill Lynch Wealth Management and US Trust not only launched 180 ESG-themed investments, but also announced that they would provide certain clients with a proxy voting service to allow them “to delegate

102. Interfaith Center on Corporate Responsibility, *2013 Proxy Resolutions and Voting Guide*, page 101. Available at <http://www.iccr.org/publications/index2.php>.

103. Ibid.

104. Jessie Smith Noyes Foundation, Proxy Votes. Available at <http://www.noyes.org/mission-based-investing/proxy-votes> (accessed October 2013).



proxy voting authority to a service provider who will vote proxies on their behalf in accordance with SRI guidelines.”<sup>105</sup>

Dana Lanza of Confluence Philanthropy also contends that foundations should be able to have the proxies in their shares of pooled funds voted in line with their ESG criteria. With Confluence Philanthropy’s Proxy Power Program, she and her team have drafted six principles to guide the proxy voting of fund managers with foundation clients. Confluence plans to invite foundations to sign on in support of the Principles and then to use the endorsements to ask the top 12 investment managers for foundations to adopt these six principles and to create parallel accounts for foundation clients.

### Confluence Philanthropy: Endowments & Foundations’ Six Principles for Proxy Voting (US Corporations)

**Principle 1:** Corporate boards must be responsible and accountable to their owners, the shareholder. They must value and protect shareholder rights.

**Principle 2:** Board directors must be sufficiently independent of management.

**Principle 3:** Corporate boards must provide oversight of company management, and design financial incentives that responsibly empower and motivate executives.

**Principle 4:** Reports and accounts must be accurate and timely. Boards must value and aspire to transparency in areas of interest, or concern, to investors and stakeholders.

**Principle 5:** Corporate boards must identify and manage both short and long-term risks effectively.

**Principle 6:** Corporate boards must nurture and facilitate opportunities for growth and use financial, physical and human capital wisely. Identifying and addressing the interests of stakeholders (e.g. customers, employees and communities) is essential to company success.

## Engaging in Dialogue with Corporate Management

Foundations can also communicate directly with corporate management about ESG concerns, whether or not a shareholder resolution is being filed. Foundation officers or trustees can write letters to or request meetings with company executives and board members about ESG issues that affect the long-term value of the company. In this way, foundations can help steer the companies in which they have ownership stakes toward greater sustainability and protection of assets.

Coordinating with other investors can help increase the visibility of the shareholder advocacy efforts. For example, investors will often co-sign letters with dozens of investors representing billions of dollars in assets under management. With the release of the signed statements to media outlets, the messages can be picked up in blogs and social media and increase the likelihood that companies will address the issues raised.

In 2012, several foundations and other investors, organized by Walden Asset Management, signed an open letter to Amgen concerning its membership with the American Legislative Exchange Council (ALEC), which suggests “model” legislation for state legislatures on a number of controversial topics. The participating foundations included the Brainerd Foundation, Christopher Reynolds Foundation, Jessie Smith Noyes

105. Alexandra Villarreal, “BoFA Merrill Lynch, U.S. Trust launch program to align investor values with investments,” *Bank Credit News*, August 30, 2013. Available at <http://bankcreditnews.com/investment/bofa-merrill-lynch-u-s-trust-launch-program-to-align-investor-values-with-investments/12442/>.



Foundation, Merck Family Fund, Nathan Cummings Foundation, Needmor Fund and the Russell Family Foundation. They believe that ALEC’s positions in support of Stand Your Ground laws, restrictive immigration policies and efforts to restrict the authority of the Environmental Protection Agency posed reputational risks to its corporate members that outweighed the benefits of membership.<sup>106</sup> In response to the letter, Amgen decided to discontinue its membership with ALEC in August 2012.<sup>107</sup> As of September 2013, almost 50 corporations had dropped membership with the Council after receiving similar letters from the coalition.

In May 2013, the Interfaith Center on Corporate Responsibility, along with Boston Common Asset Management, Domini Social Investments, the Mission Oblates of Mary Immaculate and Trillium Asset Management, drafted an Investor Statement on Bangladesh soon after the Rana Plaza factory collapse that killed over 1,000 garment workers.<sup>108</sup> Investors representing more than \$1.5 trillion signed the letter, indicating their support for human rights and labor rights in apparel companies and businesses with global supply chains broadly.

Joining Shareholder Coalitions

Foundations can leverage their ownership stakes by joining coalitions of shareowners and other institutional investors. By participating in these networks, investors are better able to learn the best practices of and various approaches to shareholder engagement. Some shareholder networks also provide useful platforms for identifying companies with issues of mutual concern, communicating directly with corporate management (through letters or meetings), and finding potential co-filers for shareholder resolutions. The information and resources that shareholder coalitions provide help minimize the time, effort and costs involved for shareholder engagement activities.

Shareholder Engagement Networks
Ceres Investor Network on Climate Risk
Interfaith Center on Corporate Responsibility
International Corporate Governance Network
Investor Environmental Health Network
Thirty Percent Coalition
US SIF: The Forum for Sustainable and Responsible Investment

The Thirty Percent Coalition, for example, represents institutional investors, senior business executives, board members, corporate governance experts and senior business executives who seek to achieve greater gender diversity on the boards of US publicly traded companies. The Coalition’s goal is for women to hold at least 30 percent of all board directorships at public companies by 2015—up from about 13 percent today. In February 2013, the Thirty Percent Coalition launched a letter campaign to major listed companies without any female representation on their boards urging them to make greater efforts to increase board diversity. The signatories represented approximately \$1.2 trillion in assets under management.<sup>109</sup> Institutional investors have filed shareholder resolutions or engaged in other follow-on activities with the companies that have not responded to the letter.<sup>110</sup>

106. Investor Letter to Amgen, Inc. Available at [http://alecexposed.org/w/images/f/fe/ALEC\\_Outreach\\_Letter\\_-\\_Amgen\\_Inc\\_.pdf](http://alecexposed.org/w/images/f/fe/ALEC_Outreach_Letter_-_Amgen_Inc_.pdf).  
107. SourceWatch, *Corporations that have cut ties to ALEC*, [http://www.sourcewatch.org/index.php/Corporations\\_that\\_Have\\_Cut\\_Ties\\_to\\_ALEC](http://www.sourcewatch.org/index.php/Corporations_that_Have_Cut_Ties_to_ALEC) (accessed October 2013).  
108. Interfaith Center on Corporate Responsibility, *Press Release—Diverse Coalition of Global Investors Managing More than \$1.5 Trillion Calls for Systemic Reforms to End Human Rights Abuses in Apparel Supply Chains*, May 22, 2013. Available at [http://www.iccr.org/news/press\\_releases/2013/pr\\_bangladesh052213.php](http://www.iccr.org/news/press_releases/2013/pr_bangladesh052213.php).  
109. Thirty Percent Coalition <http://www.30percentcoalition.org/> (accessed October 2013). The letter can be found here: [http://www.30percentcoalition.org/images/Initiatives/2013-01-30\\_30%20Coalition%20Letter%20to%20R1000%20Companies%20-%20FINAL.pdf](http://www.30percentcoalition.org/images/Initiatives/2013-01-30_30%20Coalition%20Letter%20to%20R1000%20Companies%20-%20FINAL.pdf).  
110. US SIF and Ceres, *Comment Letter RE: Support for Carbon Pollution New Source Performance Standards for Power Plants and a call for Existing SourceStandards*, September 20, 2013. Available at [http://www.ussif.org/files/Public\\_Policy/Comment\\_Letters/Carbon\\_Pollution\\_Standards\\_Investor\\_ltr.pdf](http://www.ussif.org/files/Public_Policy/Comment_Letters/Carbon_Pollution_Standards_Investor_ltr.pdf).

In September 2013, US SIF and Ceres, an investor coalition that works with companies to address sustainability issues, jointly organized a policy letter to voice support for the US Environmental Protection Agency's proposed Carbon Pollution Standard for new power plants, which for the first time establishes limits on the greenhouse gases that electric power plants may emit. The letter also urges the Obama Administration to take the next step in creating a carbon pollution standard for existing power plants. Investors representing \$900 billion in assets under management signed the letter.

## Comprehensive Shareholder Engagement

Many foundations involved with shareholder engagement, including some of those highlighted earlier in this chapter, have a comprehensive policy employing all shareholder strategies. Using all available strategies can reinforce the effectiveness of a foundation's corporate engagement efforts.

One such example is the Christopher Reynolds Foundation (CRF), a small foundation with one professional staff member and \$24 million in assets under management. CRF votes all of its proxies, directly and through its asset managers, by reviewing votes in accordance with its guidelines. The foundation also co-files a number of resolutions each year identified by its managers. In addition, the foundation is the primary filer of some resolutions and engages in dialogue with companies. It has been in dialogue with ExxonMobil and Chevron for a number of years on various aspects of climate risk. Its engagements with Pfizer have led to greater transparency on political spending. It is holding discussions with Accenture on the discrepancies between its corporate statements on societal and environmental issues and its involvement with trade associations, particularly the US Chamber of Commerce, that espouse opposing views.

Steve Viederman, the chair of the finance committee at CRF and a former President of the Jessie Smith Noyes Foundation, prefers the term "active shareowners" rather than the more passive "shareholders" to emphasize the commitment and activism of CRF. Viederman says that CRF takes seriously its fiduciary duty to holistically serve the public benefit with all of its resources. He also notes the support from the Board of Directors: "As shareowners the Board takes stewardship seriously."

## Conclusion

Foundations in the United States collectively control billions of dollars in assets beyond what they pay out in grants or program-related investments. Currently, the investment strategies for most of these assets do not affirmatively contribute to their mission goals and broader concepts of investor responsibility. As this report has shown, foundations have opportunities to employ sustainable and responsible investing strategies across their portfolios.

John Powers of the Educational Foundation of America, which has employed SRI strategies for over 20 years, says of the common disconnect between the investment practices of foundations and their programmatic and larger social goals: “Typically foundations allow their financial managers to make as much money as possible *any way they can* so they’ll have more to give away in grants. But foundations exist to leverage social change. Therefore, foundations have a fiduciary responsibility to the public to utilize every tool and means available to them, including managing their endowments to complement their grantmaking to achieve social or community benefit.”

Today, relatively few foundations are taking advantage of mission, impact or other sustainable and responsible investing strategies. The foundations that consider environmental, social and governance criteria across most or all of their assets or practice shareholder advocacy and engagement tend to be smaller in terms of assets under management.

Dana Lanza, the CEO of foundation membership association Confluence Philanthropy, describes the barriers—financial, social and cultural, and institutional—that foundations, particularly larger foundations, often face that hinder their adoption of SRI strategies.

Financial barriers, Lanza says, are barriers of scale. The largest foundations, which have billions of dollars in assets under management, are challenged in finding enough investment opportunities, particularly in alternative investment asset classes. However, while the limited investment vehicles available at the appropriate scale can be a constraint for foundations exploring alternative and community investments for social impact, this is generally not the case for public equities and fixed income.

A greater challenge, in Lanza’s view, is that foundations may face social and cultural barriers—in essence a reluctance or unwillingness to change established policies. Their staff members may find it difficult to question and change long-standing precedents and standards within their organizations, especially without support from the board and top management. For foundations with separate staffs focused either on programs or investments, it can be difficult to bring about cross-cutting brainstorming between these two sets of expertise. In fact, several of the smaller foundations that have pursued mission-related investing have said part of their success has stemmed from removing the physical barriers between investment and program personnel and encouraging more communication between them.

Finally, foundations may experience institutional barriers to change. Many directors and trustees at the largest foundations are affiliated with major corporations, and foundation staff may not be at liberty to screen, divest from, or engage in shareholder advocacy with publicly traded companies as a result.

Thus, most of the barriers to the practice of sustainable and responsible investing among foundations appear to stem from cultures and precedents they have developed internally over time. That these internal barriers can fall away is demonstrated by the many foundations that have successfully adopted or pursued SRI strategies, sometimes after a change in leadership.

Foundations interested in exploring sustainable and responsible investing can look to those that have already successfully implemented SRI strategies. Early adopters have examined their missions and values to guide their development of SRI investment priorities and policies. Some have chosen to invest in community development financial institutions to support job creation and to help combat poverty, or to deploy capital to private equity funds and companies working to develop products and services to serve environmental and societal needs. With regard to public equities, foundations have employed investment managers or invested in funds with expertise in assessing ESG criteria, ensured that they (or their managers) vote their proxies in line with their foundations' values, and filed shareholder resolutions or joined investor coalitions on ESG issues of particular interest.

As the SRI industry expands, so do the resources available for foundations to become active participants in the space. Associations such as US SIF, Confluence Philanthropy and Mission Investors Exchange, among others, support foundations by providing education, training and other programming on various areas of SRI. In addition, SRI consultants and investment managers provide foundations with important services, such as developing mission-related investment strategies, identifying specific investment opportunities, forecasting financial performance and taking the lead on shareholder engagement opportunities.

To summarize recommendations from throughout this paper, foundations can take five steps to begin the process of harnessing their assets to meet their unique mission and ESG values.

- 1) **Resources:** Take advantage of the resources available, many of which are free of charge, which range from organizations that support and advance this field to numerous reports and studies. This report and the resources listed here are a good place to start.
- 2) **Internal organization:** Bring investment and program personnel together to determine ways to facilitate the consideration of mission and ESG goals in the investment of the endowment. Some effective strategies include having personnel from both departments work in shared office areas and participate in joint meetings. Consider appointing program officers to the investment committee.
- 3) **Investment managers:** Explore your interest in SRI options with your investment consultant or advisor and ask whether the consulting practice has SRI experts with whom you can confer. Consider moving part or all of your investment portfolio to an investment manager that has SRI expertise.
- 4) **Proxy voting policies:** Establish ESG proxy voting guidelines, and speak with your investment managers about their proxy voting policies. Request that they vote your shares in accordance with your guidelines. Consider hiring an outside firm for assistance in digesting and analyzing the questions that appear in company proxy statements before casting your shares. For investments in mutual funds or other investment vehicles that do not allow you to vote your proxies directly, find out how the fund's shares will be voted on your behalf. Request that your mutual fund or financial advisors vote thoughtfully on ESG issues and not automatically in accordance with the recommendations of portfolio companies' managements.
- 5) **Shareholder resolutions:** Consider filing or co-filing shareholder resolutions. Associations such as US SIF, Ceres and the Interfaith Center on Corporate Responsibility are helpful platforms for foundations and other investors to learn about corporate ESG issues of concern and to garner support for shareholder resolutions.

Foundations have taken on the commendable task of addressing myriad societal and environmental challenges—poverty and unemployment, gender and racial inequities, excessive corporate influence on the political process, global warming and many others. By employing responsible investing strategies, they can deploy more of their extensive resources in financial and human capital to further their missions and maximize their ability to achieve positive societal impact.

# Resources

## Organizations/Projects

### General

**Association of Small Foundations:** <http://www.smallfoundations.org/>  
**Center for Effective Philanthropy:** <http://www.effectivephilanthropy.org/>  
**Chronicle of Philanthropy:** <http://philanthropy.com/>  
**Confluence Philanthropy:** <http://www.confluencephilanthropy.org/>  
**Council on Foundations:** <http://www.cof.org/>  
**Foundation Center:** <http://foundationcenter.org/>  
**Foundation Source:** <http://www.foundationsource.com/>  
**Global Impact Investing Network (GIIN):** <http://www.thegiin.org/>  
**ImpactAssets 50 (a project of ImpactAssets):** <http://www.impactassets.org/impactassets-50>  
**Impact Base (a project of GIIN):** <http://www.impactbase.org/>  
**Mission Investors Exchange:** <https://www.missioninvestors.org/>  
**Principles for Responsible Investment:** <http://www.unpri.org/>  
**US SIF: The Forum for Sustainable and Responsible Investment:** <http://www.ussif.org/>  
**US SIF Financial Directory:** [http://www.ussif.org/AF\\_MemberDirectory.asp](http://www.ussif.org/AF_MemberDirectory.asp)  
**US SIF Mutual Fund Chart:** <http://charts.ussif.org/mfpc/>  
**US SIF Separate Account Managers in Sustainable and Responsible Investment:**  
<http://charts.ussif.org/sam/>

### Community Investment

**CARS™:** <http://carsratingsystem.net/>  
**Coalition of Community Development Financial Institutions:** <http://www.cdfi.org/>  
**Community Development Bankers Association:** <http://www.cdbanks.org/>  
**National Community Investment Fund:** <http://www.ncif.org/>  
**National Federation of Community Development Credit Unions:** <http://www.cdcu.coop/>  
**Opportunity Finance Network:** <http://www.opportunityfinance.net/>

### Shareholder Engagement

**As You Sow:** <http://www.asyousow.org/>  
**Confluence Philanthropy – Proxy Power Program and Proxy Stewardship Initiative:**  
<http://www.confluencephilanthropy.org/?page=ProxyPowerProgram>  
**Glass, Lewis, and Co.:** <http://www.glasslewis.com/>  
**Interfaith Center on Corporate Responsibility:** <http://www.iccr.org/>  
**Investor Voice:** <http://www.investorvoice.net/>  
**ISS, a division of MSCI:** <http://www.issgovernance.com/>  
**Sustainable Investments Institute:** <http://www.siinstitute.org/>



## Select Sample of Foundation SRI Policies

**Annie E. Casey Foundation:** <http://www.aecf.org/OurWork/CommunityChange/SocialInvestments.aspx>

**Blue Moon Fund:** <http://www.bluemoonfund.org/investing/>

**Cordes Foundation:** <http://www.cordesfoundation.org/what-is-impact-investing-and-why-are-passionate-about-it/>

**Educational Foundation of America:** <http://www.theefa.org/responsible-investments/>

**F.B. Heron Foundation:** <http://fbheron.org/investments/>

**Jessie Smith Noyes Foundation:** <http://www.noyes.org/mission-based-investing/investment-policy>

**KL Felicitas Foundation:** [http://www.klfelicitasfoundation.org/index.php/impact\\_investing/](http://www.klfelicitasfoundation.org/index.php/impact_investing/)

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## Glossary of Terms

**Alternative Investment Funds:** Funds that are typically organized as limited partnerships or limited liability corporations and are lightly regulated, and therefore available exclusively to accredited investors, such as foundations. Such funds include private equity and venture capital, hedge funds, and property and real estate funds.

**CDFI:** A US bank, credit union, loan fund or equity that is certified as a community development financial institution by the US Treasury's CDFI Fund.

**Community Investing:** Capital from investors, as well as financial services and technical support, that are directed to communities underserved by traditional financial services.

**ESG:** Abbreviation for “Environmental, Social and Governance” criteria or factors, incorporated into investment analysis, policy or management.

**Fossil Fuel Divestment:** Selling currently held stocks and other investments in fossil fuel companies.

**Impact Investing:** Impact investments are investments made into companies, organizations, and funds with the intention to generate measurable social and environmental impact alongside a financial return. (Global Impact Investing Network—GIIN)

**Mission Investments:** A term that includes both mission-related investments and program-related investments. (Mission Investors Exchange)

**Mission-Related Investment (MRI):** MRIs are market-rate investments that support the mission of the foundation by generating a positive social or environmental impact. These investments are made from the foundation's endowment corpus. MRI opportunities exist across asset classes in cash, fixed income, public equity, private equity and venture capital, and real estate. (Adapted from Mission Investors Exchange)

**Private Foundation:** Foundations are non-profit organizations that support charitable activities for the public good. A private foundation is distinguished from a public charity in that it is funded by a single source—such as one individual, family, or corporation—rather than multiple sources. Therefore, private foundations do not depend on public charity and do not actively fundraise or apply for grants.

**Program-Related Investment (PRI):** PRIs are defined by the IRS tax code. They constitute investments for which the primary purpose is to accomplish one or more of the foundation's exempt purposes, and for which production of income or appreciation of property is not a significant purpose. A PRI may produce at market, above market, or below market returns. A PRI is eligible to count against the 5 percent payout that foundations are required to make each year to retain their tax-exempt status. (Adapted from the Internal Revenue Service)

**Proxy Statement:** Term used to describe the documentation that publicly traded companies are required by law to distribute to shareowners prior to their annual meetings. In the proxy, companies report to their shareholders and solicit votes on a variety of matters related to the companies' management and governance, including shareowner-sponsored resolutions on environmental, social and corporate governance issues.

**Shareholder Advocacy or Shareholder Engagement:** The active exercise of the rights and responsibilities of corporate shareownership, including options such as filing or co-filing shareholder resolutions or engaging directly with corporate management through correspondence, dialogue and meetings over issues of concern.

**Sustainable and Responsible Investment (SRI):** SRI is an investment discipline that considers environmental, social and corporate governance (ESG) criteria to generate long-term competitive financial returns and positive societal impact. SRI strategies include both ESG incorporation in investment decision-making as well as shareholder engagement. Most SRI investors seek market-rate returns, but some accept below-market returns to achieve outsized environmental or social impact. SRI can be practiced across all asset classes.

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